Commission of Inquiry
into
Residential Tenancies

The Rent Control System in Quebec

François des Rosiers

Research Study No. 25

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by

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The views expressed in this paper are those of the author and not necessarily those of the Commission.

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FOREWORD AND ACKNOWLEDGEMENTS

The objective of the current paper is to present the Ontario Commission of Inquiry into Residential Tenancies with a detailed description of the characteristics and mechanics of rent control in Quebec, so as to help it in its task of assessing the virtues and weaknesses of the system prevailing in Ontario. It should be stressed that this document, which was worked up over a fortnight or so, remains mostly descriptive and is by no means intended, unlike some major studies deposited before the Commission, to provide a deep theoretical understanding or critical analysis of rent control and its effects on real estate markets; nor is it meant to be a comparative study of various systems operating in Canada, the United States or Europe.

Despite our relatively modest mandate, we did our best to collect as much information on rent control in Quebec as could possibly be made available from various sources and within a short period of time. In that respect, we are particularly grateful to MM. Jean-Guy HOUDE and Paul FOREST, respectively President and Chief Economist of the Régie du logement, who kindly agreed to provide us with all the basic and updated information necessary to fulfil our task, as well as to MM. Michel RIVERIN and André DES ROCHERS, respectively General Manager and member of the Board of Directors of the Corporation professionnelle des propriétaires immobiliers du Québec (CORPIQ) for their assistance in appraising the impact of rent control on real estate investors' behaviour. We also appreciated the precious cooperation of Professor Denis CHAPUT, from the Hautes études commerciales (HEC), Montreal University, who provided us with a report he wrote in 1978 that was to form the theoretical basis for the rent control system as it now prevails in Quebec.

We did as well benefit from the spontaneous contribution of Mr. Claude DAGNEAU, from the Tenants' Association of Côte-des-Neiges, Montreal, which made it possible for us to draw a broad picture, succinct though it might be, of how tenants and their representatives view the rent control system in Quebec.

Finally, we wish to thank MM. Don JACK and John TODD, respectively Counsel and Director of Research for the Commission, for having committed to us the responsibility of this mandate while providing at the same time useful suggestions and insights for the preparation of the current paper.

1. INTRODUCTION: REGIE DU LOGEMENT INSTITUTIONAL CONTEXT, MAIN FUNCTIONS AND RESPONSIBILITIES UNDER THE CURRENT LEGISLATION

1.1 Origin of the Régie du Logement

The «Régie du Logement», hereinafter referred to as «the Régie», is a body of the Government of Quebec that was established under the Act respecting the «Régie du Logement» (Act 107) and which came into effect on October 1st, 1980. The Régie that came as a replacement for the former «Commission des loyers», is answerable to the Minister of «l'Habitation et de la protection du consommateur».

1.2 Aim of the Régie

The basic philosophy that prevailed to the establishment of the Régie rests upon the principle that harmonious relationships between landlords and tenants will emerge from better information on their respective rights and duties and that, where this cannot be achieved, the Régie will help them settle their disputes in a fair and just manner and in the best possible atmosphere. We shall come back on that issue later on in this paper while trying to assess whether or not the Régie reaches its aim.

Thus, the Régie is actually a tribunal with the double mandate of deciding on claims submitted to it and, where possible, bringing landlords and tenants together. It should be stressed that the mandate of the Régie is not to set rent universally or globally, but to favor above all negociation and private settlement between the two parties. Consequently, it intervenes only in a limited number of cases accounting for between 5 percent and 10 percent of the rental market and operates on a case by case basis; even then, only a fraction of all claims presented before the Régie will actually be settled through a decision by the tribunal. In 1984 for instance, 80 840 claims were processed by the Régie, representing roughly

7.6 percent of total rental units in the Province[2]. On that amount, slightly below two thirds (53 230) ended up with a formal decision, the remaining third being settled either through direct negotiation between the landlord and his tenant (6.5%) or via conciliation before the Régie (27.7%).

1.3 Jurisdiction of the Régie

The Régie has jurisdiction over all premises leased for residential purposes: dwellings, rooms, mobile homes and land intended for the installation of a mobile home, including services, accessories and dependencies, even if the latter are the object of a distinct lease. However, low rental housing (L.R.H.) dwellings located in buildings less than five years old and dwellings leased by a cooperative to one of its member partially escape the jurisdiction of the Régie. The Régie takes care of most disputes related to residential leases and may be called upon in the following cases:

a) for a claim concerning a lease when the amount is question is less than 15 000$;

b) for a claim, irrespective of the amount involved, concerning:

i) extending a lease;
ii) setting or adjusting rent;
iii) repossession;
iv) subdividing or changing the purpose for which the dwelling is used;
v) certain types of recourses related to leases used in low rental housing;

c) for a claim related to the preservation of dwellings, such as:

i) demolition
ii) sale of a building belonging to a building complex;

[2] By the end of 1984, total rental units in Quebec stood approximately at 1 058 000; this figure is arrived at by adding up rental units completions between mid-1981 and the end of 1984 to the existing rental stock according to the 1981 Census. Demolitions and conversions are therefore omitted in the calculation.

iii) transformation of a building into co-ownership (undivided or condominium)[3].

Finally, it should be stressed that all tenants and landlords are entitled to the services of the Régie, even in the absence of any lease.

1.4 Conciliation Versus Decision Rendering

As part of its mandate, the Régie offers landlords and tenants who did not manage to reach an agreement on their own a conciliation service which, without taking away their right to a fair hearing and decision, often allows them to arrive at a settlement with the help of a conciliator specialized in this type of approach. Where even such an attempt fails, the Régie is required to settle the case which is done through rendering a decision after a hearing during which the parties are heard by a commissioner or, eventually, a special clerk of the court. Parties may, if they wish, be represented by a lawyer except in the case of small claims.

A 20.00$ fee must be paid down upon applying before the Régie, which shall be reimbursed if an agreement is reached prior to the hearing. However, no fee is required in the case of applications for setting or adjusting rent and for modifying a lease. Welfare recipients are also exempt from any fee.

---

[3] The moratorium imposed several years ago by the Minister of Housing and preventing any rental unit in buildings of more than five dwellings from being converted into condominiums unless all tenants agree still holds. A decision on that issue is expected sometime next Fall.

2. RENT CONTROL IN QUEBEC: OBJECTIVE AND LEGAL PROCESS

As was shown above, the jurisdiction of the Régie extends quite far into nearly all aspects of residential rental activities. Yet, the rent control issue remains the prominent one, upon which we shall now lay emphasis. Although rent control has been going on in one form or another for quite some time in Quebec, it has reached its full maturity with Act 107 establishing the Régie du logement. We shall now look at the objective of the system and at the legal process surrounding it, before investigating further into its mechanics and incidence.

2.1 Objective of Rent Control

Basically, the objective of the rent control system in Quebec is to PREVENT EXCESSIVE RENT RISES so as to maintain a «fair» level of rent, while still allowing for a «reasonable» return to be realized by the landlord on his investment. Several points emerge from such a statement, which need to be clarified:

a) Firstly, it is important to stress that the system is designed to regulate RENT RISES, not the absolute level of rent. Thus, the level of rent which serves as the basis for calculating yearly increases is implicitly assumed to be a «fair» one. In other words, where a discrepancy exists between, on the one hand the rent charged to the tenant for a given type and quality of rental dwelling with specific locational attributes and, on the other hand, the market rent for similar premises, no provision of the Act will allow the Régie to adjust that rent either upwards or downwards. The problem, of course, will rarely arise with respect to higher - than - market rents, since market mechanism will sooner or later provide for a downward adjustment of such rents to competitive levels, the alternative being that the dwellings remain unoccupied. In contrast, if, for some reason, the rent charged for a unit proves to be below what the market would command at the time

of falling under the jurisdiction of the Régie, then the discrepancy will be maintained thereafter.

Therefore, it should be made clear that the rent control system prevailing in Quebec cannot ensure «fair» levels of rent, unless it is assumed that the rents charged for dwellings are already «fair» ones from the start, that is such rents are actually adequate basis on which to calculate rent rises.

b) Secondly, the use of concepts such as «fair rent» and «reasonable return» is likely to bring ambiguity into the interpretation of the fundamental goal the system seeks to achieve. Indeed, the «fair rent» concept may take two different meanings depending on whether it applies to the tenant or to the investor/landlord. In the first case, a «fair rent» refers to the reasonable proportion of a tenant's gross income that may be devoted to housing expenditures, considering all other basic expenses he must face; traditionally, it is considered - although somewhat arbitrarily - that 25 percent is the maximum a household should spend on housing. From an investor's point-of-view however, a «fair rent» is that rent which provides him with a «reasonable» return on his investment, that is with a return similar to what would have been available fr[illegible] any other asset offering an equivalent level of risk. Only such a rent will induce investors to produce new residential units so as to meet rental demand.

Having said that, there is no reason why these two definitions of a «fair rent» should necessarily coincide. Besides, the rent control system as it is cannot guarantee a reasonable return to the investor, but may at the very most allow him to realize such a return (by not preventing rents from rising), provided the market itself is able to generate it. Basically, it is possible to illustrate the role a rent control system may play by conceiving two diametrically opposed market contexts:

i) Let us first assume a situation where the supply of rental units is scarce relative to the demand, which, in an uncontrolled market,

would tend to push up rents. Under such conditions, controlling rent increases will limit investors' return and, ultimately, the increase in value of rental buildings (the value of a building being the direct reflection of the potential net income it can yield over a given period of time) to a level that will be necessarily lower than the one prevailing in an uncontrolled market. If this were not the case, there would be no justification on which to ground rent control.

ii) Let us now assume a situation whereby an over-supply of rental units significantly increases inoccupancy rates, thereby driving rents down or, to be more realistic, preventing them from rising (which, in real terms, is equivalent to a drop in rent levels). Under such circumstances, there is no need for controlling rent increases, since the latter are virtually non-existent due to competition between investors/landlords.

In light of such considerations, the objective of the Quebec rent control system may be reformulated as follows: it aims at limiting rent rises to the amount which is needed to compensate for increases in operating costs, replacement costs and in the marginal cost of capital so as to keep real estate returns in line with normal returns available on alternative assets of equivalent risk and to prevent rental building values from dropping, while ensuring at the same time that the tenants' situation does not deteriorate unduly. Therefore, any rent increase greater than what is allowed based on those standards would be considered as «excessive» and consequently detrimental to the tenant of the premises.

We shall later on investigate in greater depth the basic rationale of real estate investment. Before doing so, let us focus on the legal process pertaining to the rent control issue in Quebec.

2.2 The Legal Process

In the current section, we will confine ourself to the description of the legal process followed for claims concerning setting (or adjusting) rent. Several steps are involved:

Step 1: If a lessor (the landlord) wishes to increase rent or modify a term of the lease, he must give the lessee (the tenant) written notice within the time limits prescribed by the Civil Code. For fixed term leases of twelve (12) months or more, that notice should reach the tenant between three (3) to six (6) months before the end of the lease, whereas for other term leases (either less than 12 months or indeterminate), the time limit is set between one (1) to two (2) months.

Step 2: If the tenant disagrees with the proposed rent increase or change in terms, he must, in turn, give the lessor written notice within one (1) month or receipt of the landlord's notice. If he doesn't, he is deemed to have accepted the new rent or the new terms proposed by the landlord.

Step 3: Following the tenant's refusal, the landlord must within one (1) month of receiving his notice submit an application for setting rent to the Régie. Should he fail from doing so, the lease would be extended without modification.

Step 4: Once his claim has been submitted to the Régie, the lessor will receive from the latter a form referred to as the «IN» form (Information Necessary for Fixing the Rent), which he must fill in and return to the Régie before the prescribed deadline. Upon completion, this form will display the income and expenditures for the building in which stands the dwelling concerned by the claim, and it will serve as the basis for determining rent (i.e. the rent increase if any), according to prescribed criteria that will be looked upon in the next section. The landlord should be able, at the hearing, to supply proof of the information he has supplied in the «IN» form.

Step 5: The Régie issues a notice of hearing, whereby the parties are informed of the date, time and place of the hearing. The hearing may be postponed to a later date upon the request of either party, provided a written statement is produced before the Régie by the demander showing the other party agrees. At the hearing, the commissioner may also, at his own discretion, or by request, postpone the session to a later date.

Step 6: The hearing itself is a session during which the commissioner hears the parties at the prescribed time and place, in order to settle the dispute. If the hearing cannot be completed within the same day, then the commissioner may adjourn the session.

Step 7: Once the hearing has been held, the commissioner takes into account the proof submitted to him and renders a written decision on these grounds, thereby determining the allowed rent rise and, consequently, the revised rent that should be paid to the landlord. Each party receives a copy of the decision.

Step 8: Although claims concerning setting (or revising) rent are not subject to appeal in a Provincial Court, they may be revised by the Régie itself, provided the appeal is submitted within one (1) month of the decision. The parties are then called to a new hearing, held before two commissioners whose decision is final and cannot be appealed.

From the above procedure, two features may be brought out as being particularly characteristic of the rent control system in Quebec:

a) firstly, it is incumbent on the lessor, not on the tenant, to bring the case before the Régie;

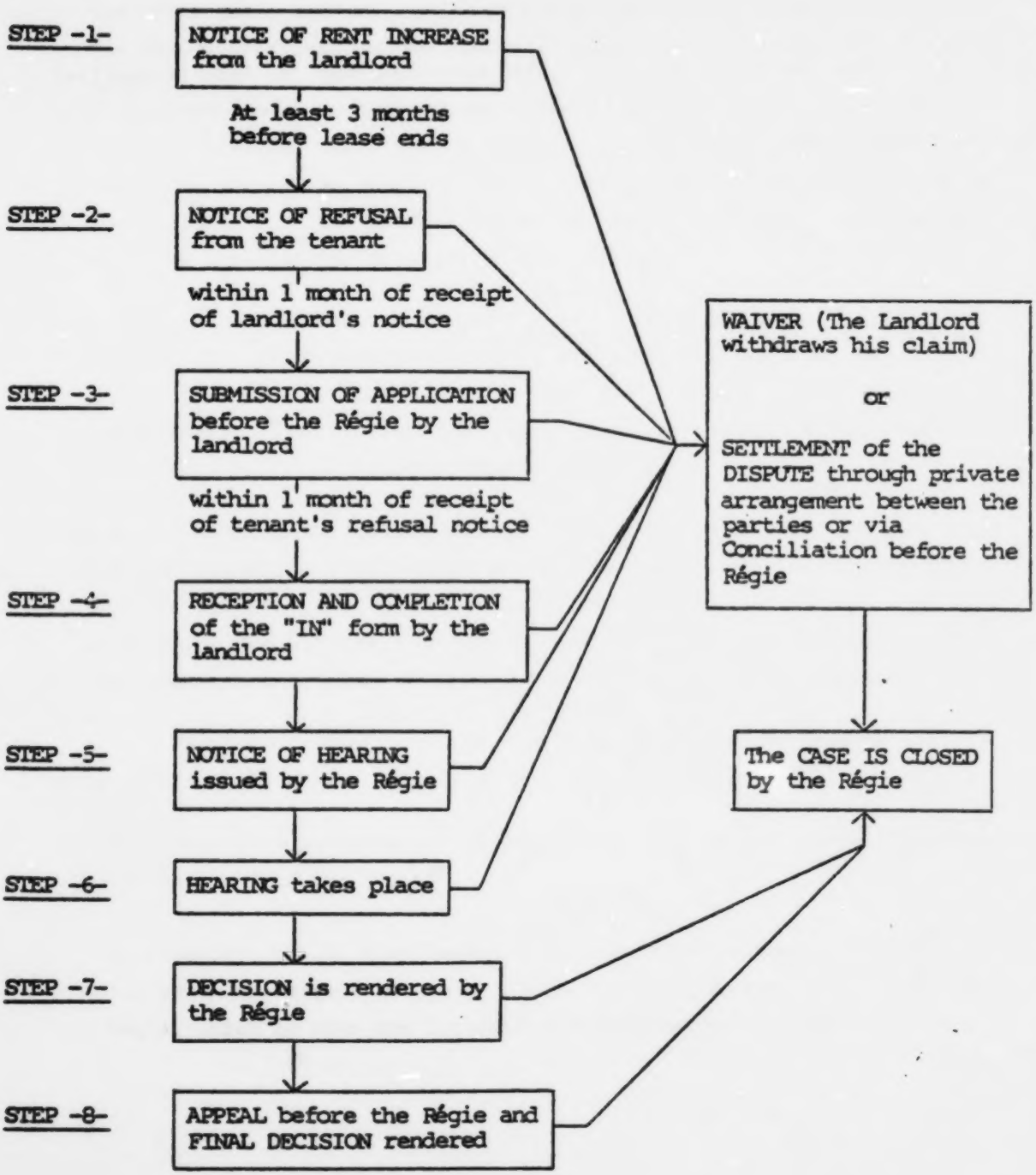
b) secondly, unlike what happens with most other claims, the final decision with respect to rent review related issues rests with the Régie, which is thus the ultimate authority on the matter.

Finally, it should be mentioned that a landlord may withdraw his claim at any time before a decision is rendered; similarly, the parties remain free to reach an agreement at any time before the hearing takes place, or even at the hearing itself. In both cases, the Régie closes the case upon presentation of a written statement.

The procedure we have just described may be best summarized through the following diagram schematizing the various steps involved in a rent setting case (Table 1).

TABLE 1

Rent Setting Procedure in Quebec


STEP -1-
NOTICE OF RENT INCREASE from the landlord
At least 3 months before lease ends
STEP -2-
NOTICE OF REFUSAL from the tenant
within 1 month of receipt of landlord's notice
STEP -3-
SUBMISSION OF APPLICATION before the Régie by the landlord
within 1 month of receipt of tenant's refusal notice
STEP -4-
RECEPTION AND COMPLETION of the "IN" form by the landlord
STEP -5-
NOTICE OF HEARING issued by the Régie
STEP -6-
HEARING takes place
STEP -7-
DECISION is rendered by the Régie
STEP -8-
APPEAL before the Régie and FINAL DECISION rendered
WAIVER (The Landlord withdraws his claim)
or
SETTLEMENT of the DISPUTE through private arrangement between the parties or via Conciliation before the Régie
The CASE IS CLOSED by the Régie

3. THE MECHANICS OF RENT CONTROL IN QUEBEC

In the current chapter, we shall perform a detailed analysis of the method used by the Régie to determine rent rises. Beginning with a broad description of the main variables accounted for in the method, we shall interpret the latter in the light of the fundamentals of real estate investment before venturing into the very mechanics of the system. Finally, more specific issues will be further investigated so as to bring out the main advantages and weaknesses of the prevailing rent control process.

3.1 General Description of the Method: Some Theoretical Aspects

In conformity with the general objective of rent control as formulated earlier in the document, rent increases are determined by taking into account two sets of factors, namely FLUCTUATIONS IN COSTS incurred for operating the building and RETURN REQUIREMENTS on invested capital. More precisely, the method consists essentially of:

a) setting the rent, proportionally for each dwelling, according to the change in expenses for the building; these include expenses related to taxes, insurance, energy, maintenance and management of the building.

b) Remunerating the capital invested in the building by awarding a «reasonable» return on funds spent for repairs or major improvements and by adjusting the net income on the building so that the investment it represents remains profitable. We shall later on lay greater emphasis on the net income adjustment which is undoubtedly a major and somewhat hermetic element of the rent control system prevailing in Quebec.

By and large then, the method used in setting rent increases regards the landlord as an investor entitled to a «reasonable» return, that is a return similar to that available on any alternative investment of

equivalent risk; this refers to the «opportunity cost of capital» concept which precisely indicates the minimum acceptable rate of return, or hurdle rate an investor is likely to require from a given asset or project. Since the return on a building depends primarily on the net income it generates, any increase in operating costs will directly affect that return downwards; hence the need for counterbalancing such an effect by letting the rents rise accordingly. Besides, any rise in the general level of interest rates - that is, in the marginal cost of capital - also resulting in falling real estate values, it follows that the value of a building may only be maintained if, and only if, net operating income accruing from it is raised so as to offset the detrimental effect of interest rate fluctuations. Finally, the capital appreciation of a building being generally a significant component of the total return sought by an investor, it is important to see that the market value of real estate increase over time; to put it another way, the long-term, overall investment return on a property may only reach competitive levels in as much as expectations about the appreciation in the asset's value over the holding period do materialize. This, in turn, requires that net income be further adjusted upwards. Thus, as will be clearly illustrated later on, the net income adjustment mechanism is itself a twofold process operating under various market conditions and designed at preventing overall investment returns from falling below competitive levels.

Further insight into the rent setting process may be gained by looking at the fundamentals of real estate investment. Basically, it can be said that the market price that should be paid today for a building directly mirrors its ability to generate income, now and in the future, as well as its appreciation over time. To put it more precisely, the NET PRESENT VALUE of a real estate asset equals the summation of all income flows, net of expenses, that are expected to accrue from it over a given period of time (the holding period of the asset), plus the market value of the building upon resale, minus the initial cash outlay, all future flows being discounted at the proper discount rate. This may be expressed by the following equation:

$$NPV = \sum_{t=1}^{n} \frac{NOI}{(1+i)^t} + \frac{V_n}{(1+i)^n} - ICO, \qquad (1)$$

where: NPV = Net Present Value of the Investment

NOI = Net Operating Income

V_n = Market value of the building upon resale at time t=n

ICO = Initial cash outlay at time t=0

i = Discount rate

n = Number of holding years.

A positive NPV indicates the investor is granted with a surplus above and over the minimum return required, whereas a negative NPV implies that, considering his initial cash outlay, the investment will yield a rate of return which does not match the required one. Finally, a NPV equal to «0» indicates the discount rate used in the calculation precisely corresponds to the actual «internal rate of return» (IRR) of the investment[4].

For the sake of our demonstration, let us assume the investor has purchased the property outright, that is without any leverage[5], and that the initial cash outlay is actually the price paid for the property at time t=0. Equation (1) then becomes:

$$NPV = \sum_{t=1}^{n} \frac{NOI}{(1+i)^t} + \frac{V_n}{(1+i)^n} - P_o \qquad (2)$$

where P_o = Purchase Price at time t=0.

Besides, we can state that the market value of the building at the time of purchase - in other words, its present value - is equal to the

[4] The technical definition of the IRR is that discount rate which just causes the NPV equal to zero.

[5] This assumption actually allows us to use net operating income rather than cash-flows as the basis for our calculation, debt servicing costs being non-existent.

purchase price (Po) plus NPV, which allows for a further transformation of equation (2) into the following:

$$V_o = \sum_{t=1}^{n} \frac{NOI}{(1+i)^t} + \frac{V_n}{(1+i)^n} \qquad (3)$$

where V_o = Market value of building at time t= 0.

Thus, equation (3) clearly demonstrates the link between, on the one hand, the market value of a building and, on the other hand, the net operating income it generates as well as its increase in value over time.

We shall end this overview of the real estate investment rationale by focusing on a major element of the NPV model, namely the discount rate whose importance is obvious from the fact that any change in it will modify the market value of the building. Indeed, a rise in the discount rate will result in the latter being depressed, whereas a drop in that rate will cause the building to increase in value, for a given level of net operating income.

Despite its importance though, the «discount rate» remains relatively ambiguous in that it may refer to several concepts currently used in economic and financial issues but among which a choice is not always easy. Thus, the market determined discount rate will currently reflect the Marginal Cost of Capital, which may be defined as the rate of return available on the next best opportunity offering a similar degree of risk.

With such concepts in mind, it is easier to understand the basic rationale underlying the rent control system in Quebec; rent rises are determined so as:

a) to compensate landlords from the eroding effect increasing costs have on net operating income and, consequently, on returns and values;

b) to offset the depressing impact rises in the marginal cost of capital - and particularly in financing costs - have on real estate values and cash flows;

c) to provide for an upward adjustment of real estate values over time, thereby allowing for total return to keep in line with market expectations;

d) to reward investors making major improvements to their buildings by providing them with a return on the funds used for that purpose which is equivalent to their opportunity cost of capital.

3.2 Detailed Analysis of the Rent Setting Method

The Current section will be devoted to a thorough review of the rent setting method, each variable entering the rent rise determination process being scrutinized. Each item giving rise to a statutory adjustment factor will be accompanied by an example of how calculations were performed for the year 1985. Our analysis will follow the same sequence as that prevailing in the Calculation Form, on which final calculations leading to the rent increase are made. Before this last step, data pertaining to such calculations must be written down on the «IN» form referred to earlier, as well as on the Dwelling Schedule which provides specific information on water and service taxes as well as on major repairs and improvements that apply only to the dwelling for which a claim was made. Thus, while only one «IN» form is required for each building, the lessor should fill in as many Dwelling Schedules as there are claims within the same building.

3.2.1 Variables Accounted for in the Determination of Rent Rises

Rent rises are determined using four (4) sets of variables, that is:

- Gross Operating Income
- Operating Expenses

- Net Income Adjustment Factor
- Major Improvements and Repairs Adjustment Factor.

a) Gross Operating Income from the building includes:

i) All income from residential dwellings and non-residential dwellings (i.e. dwellings used for commercial, professional, industrial or craft purposes), as well as additional income accruing from services such as parking.

ii) Estimated rent for any dwellings which are vacant or occupied by the landlord or his family, or occupied by the janitor or other employees. The rent of such dwellings is estimated by comparing them to similar rented dwellings.

iii) Any income from additional services such as washing machines, vending machines, etc.

A major point to stress here is that the gross operating income basis from which operating expenses will be deducted refers not to EFFECTIVE income but to POTENTIAL income from the building. Therefore, neither vacancies nor bad debts are taken into account in the calculation of rent rises. We shall discuss this important issue later on.

b) Operating Expenses include:

i) Taxes and insurance costs, that is, municipal and school taxes applicable only to the building, as well as fire and liability insurance.

ii) Other expenses, namely «energy expenses» related to the use of oil, gas and electricity, «maintenance expenses» such as wages and other costs related to employees, supplies and minor repairs, and «management costs» consisting of the expenditures and time devoted to building administration.

The method used for calculating increases in operating expenses will vary depending on the items considered:

i) In the case of taxes and insurance expenses, cost rises are measured on an individual basis after the actual costs met by the landlord and are defined as the difference between costs incurred over the last period preceding March 31 for which information (e.g. a bill) is available (civil or fiscal year[6], whichever applies) and those incurred during the previous (next-to-last) year. Thus, if the rent increase which is the object of the claim refers to 1985 (for leases starting on July 1st, 1985), the rise in taxes and insurance expenses that will be taken into account in the determination of that increase is the difference in costs between:

- either 1985 and 1984 in the case of municipal property taxes which are payable in advance,
- or the fiscal year 1984/85 and 1983/84 in the case of school taxes,
- or the years 1984 and 1983 as it is for insurance expenses.

ii) As for increases related to all other operating expenses, they are calculated by applying to costs incurred over the last fiscal year average expected increase rates based on market conditions. Management costs are estimated at a fixed percentage (5%) of the building's potential gross income.

In order to provide a clear picture of how such expected rates of increase are arrived at, we shall now reproduce the method as it was applied for calculating 1985 rent rises.

---

[6] The fiscal year runs from April 1st to March 31.

ITEM -1-: OIL: The increase in the retail price of heating oil between October 1983 and October 1984 is calculated for both Montreal and Quebec City, and the resulting average rate rounded at 0.5:

TABLE 2

Average Retail Price for Heating Oil

	QUEBEC	MONTREAL
OCTOBER 1983	34.8¢	34.5¢
OCTOBER 1984	36.3¢	36.0¢
RATE OF INCREASE	4.3	4.3

Sources: Stat. Canada, cat. 62-010, table 18.

--- RETAINED RATE OF INCREASE FOR 1985: 4.0%
(rounded to nearest unity)

ITEM -2-: GAS: As the Metropolitan Gas Co. Inc. expects no rise in the costs of residential services for the current year (1985), the rate of increase for gas expenses may be considered as null.

--- RETAINED RATE OF INCREASE FOR 1985: 0.0%

ITEM -3-: ELECTRICITY: According to a press conference given on October 1984 by the President of the Board of Directors of Hydro-Quebec, no increase in the cost of electricity is expected until Summer 1985 at the soonest.

--- RETAINED RATE OF INCREASE FOR 1985: 0.0%

ITEM -4-: MAINTENANCE COSTS: In a first step, increases in labor costs, prices of maintenance products and costs of minor repairs (for which the costs of rental repairs are used as a proxy) are calculated on the basis of price or cost indices set up for 1983 and 1984. We thus have:

TABLE 3

Price and Cost Indices (1981 = 100)

	LABOUR COSTS I_1 (July)	PRICES OF MAINTENANCE PRODUCTS I_2 (September)	COSTS OF MINOR REPAIRS I_3 (June)
1983	116.1	123.7	115.2
1984	125.2	121.7	117.1
Δ% 83-84	7.8	-1.6	1.6

Sources: Stat. Canada, cat. 62-010, table 9, D-130159.
cat. 62-001, table 3.
Stat. Canada, cat. 62-010, table 9, D-130135.

Then, three size categories of building are considered; in each case, an index is set up which combines all three indices previously calculated, weighted according to the size category referred to[7]. We thus have:

CATEGORY 1: 1-20 dwellings:

$$I_A = .25I_1 + .15I_2 + .60I_3$$

CATEGORY 2: 21-200 dwellings:

$$I_B = .35I_1 + .15I_2 + .50I_3$$

CATEGORY 3: Over 200 dwellings

$$I_C = .47I_1 + .15I_2 + .38I_3$$

The resulting cost increase for each size category over the 1983/84 period is then as follows:

I_A = 2.7%
I_B = 3.3%
I_C = 4.0%

Since dwellings located in buildings of over 200 dwellings account for less than 20 percent of all dwellings subject to a claim before

[7] The weights for each size category reflects the relative importance of each variable within the category.

the Régie, the final rate of increase for maintenance costs will be the average of IA and IB:

--- RETAINED RATE OF INCREASE FOR 1985: 3.0%

ITEM -5- MANAGEMENT COSTS: Management costs are estimated at 5 percent of gross potential income; although such a figure overestimates the actual management costs met by small landlords, this will compensate for maintenance jobs they personally assume. As for cost increases, they are defined as the increase in weekly wages pertaining to the «finance-insurance-real estate» sector in Quebec between July 1983 and July 1984: wages rose from 390.86$ to 404.62$, according to a rate of increase of 3.5 percent (4.0 percent when rounded). That rate is then applied to "notional" management costs (5 percent of preceeding year's gross potential income).

--- RETAINED RATE OF INCREASE FOR 1985: 4.0%

c) Net Income Adjustment Factor, as we have seen, is designed so as to compensate investors for increases in the cost of financing (which forms an important part of the marginal cost of capital) while maintaining, or eventually increasing the market value of real estate. In fact, net income adjustment is itself the end result of two distinct operations, namely:

- A first adjustment meant to modify net income proportionately to the fluctuations in financing costs, and

- a second «additional» adjustment regarded as a premium granted to the investor and based upon market expectations, which aims at allowing the market value of the building to rise over time. This «additional» adjustment rests upon the assumption that the capital appreciation of a building is a significant component of the total return which the investor is entitled to.

On the grounds of our previous theoretical development (Section 3.1), it is now possible to assert these two apparently distinct operations are actually two complementary aspects of a same process: indeed, while a rise in interest rates - hence in the costs of financing - will tend to depress real estate values unless net income is raised accordingly (which the first adjustment does), in times of relatively low and stable interest rates real estate values will resume their ascent, provided net income, and therefore rents, are not prevented from doing so (which the second adjustment allows). Therefore, the two components of the net income adjustment factor should be seen as operating in the same direction, although under opposite economic conditions.

i) Net income adjustment related to FLUCTUATIONS IN INTEREST RATES is based on a moving average over the last five years of annual 5-year term conventional mortgage rates, with decreasing weights being attached to such rates as we go back further in time. These weights are as follows:

Year t : 0.33
Year t-1 : 0.27
Year t-2 : 0.20
Year t-3 : 0.13
Year t-4 : 0.07.

Variations in average costs of financing from one year to another are then calculated, with the surplus over and above the inflation rate (based on the Consumer Price Index) being stocked in a «reserve» and reported from year to year until it is used up. Thus, the net income adjustment factor related to interest rate fluctuations may never exceed inflation; however, it may well be negative whenever mortgage rates drop provided the negative figure thus obtained is not offset by a positive reserve of greater absolute value. Table 4 illustrates the whole calculation process.

--- RETAINED NET INCOME ADJUSTMENT FACTOR
RELATED TO INTEREST RATE FLUCTUATIONS: -3.0%

ii) Net income adjustment related to BUILDING VALUE APPRECIATION is by far the least explicit (and the most «hermetic») element of the rent rise determination method. It is actually discretionary, although not totally arbitrary, and obviously bears strong political savour. For 1985, it was established at 5.0 percent, considering the real estate market context prevailing in December 1984. The calculation leading to the determination of that item is performed in ANNEXE A.

To conclude on this important aspect of the rent rise determination process, let us assume a situation where interest rates are stable over a long period of time while inflation is constant. Under such circumstances, the net income adjustment factor pertaining to interest rate fluctuations whould be nil, even though investors are faced with constantly rising prices and costs. It should be understood that, in such a situation the total rent increase would simply be based upon on the one hand, the rises allowed for operating expenses and major repairs, and on the other hand, the increase stemming from net income adjustment related to building value appreciation.

TABLE 4

Calculation Method for Interest Rate related Net Income Adjustment Factor

t YEAR (APRIL TO MARCH)	r_t AVER. MORT RATE FOR THE YEAR %	r_t^m MOVING AVER. OVER LAST 5 YEARS %	Δr_t^m VARIATION IN r_t^m %	R_t RESERVE-REG. OF THE YEAR %	$GNI_{(t)}$ GROSS ADJUST. OF NET INC. %	$C_{(t)}$ CEILING FOR $NIA_{(t)}$ %	$NIA_{(t+1)}$ NET INC. ADJ. FOR NEXT YR. %	$R_{(t+1)}$ RESERVE-REG. OF YEAR $_{(t)}$ %
1975-76	11.512	-	-	-	-	-	-	-
1976-77	11.423	-	-	-	-	-	-	-
1977-78	10.333	-	-	-	-	-	-	-
1978-79	10.821	-	-	-	-	-	-	-
1979-80	12.626	11.458	-	-	-	-	-	-
1980-81	14.712	12.574	9.74	0.00	9.74	10.0	10.0	0.0
1981-82	19.017	14.919	18.65	0.00	18.65	12.5	12.5	6.15
1982-83	16.597	15.951	6.92	6.15	13.07	8.0	8.0	5.07
1983-84	13.026	15.375	-3.61	5.07	1.46	5.0	2.0	0.0
1984-85	13.63 (1)	14.854	-3.39	0.00	-3.39	3.0	-3.0	0.0

Source: Bank of Canada Review, Table 20 - B14024.
(1) Estimate for Dec. 1984 to March 1985.
(2) Figures rounded to the nearest .5.

--- RETAINED NET INCOME ADJUSTMENT FACTOR RELATED TO BUILDING VALUE APPRECIATION FOR 1985: 5.0%

Hence,

--- RETAINED TOTAL NET INCOME ADJUSTMENT FACTOR FOR 1985: 2.0%

d) Adjustment Factor for Major Improvements and Repairs: The Régie considers major improvements and repairs as medium-term investments and rewards landlords accordingly. In practice, the Régie measures the average return, over the last twelve months, on 5-years term investments, to which it adds a 1 percent premium in order to induce landlords to maintain the rental housing stock in good condition. Thus, between April 1984 and November 1984, the average return on 5 years guaranteed investment certificates from Trust companies stood at 12.38 percent, while it was estimated at 11.25 percent for the rest of the period. The average return on medium-term investments for the whole year was then 12.00 percent; adding up the 1 percent premium, we arrive at a figure of 13 percent for major improvements and repairs.

--- RETAINED ADJUSTMENT FACTOR FOR MAJOR IMPROVEMENTS AND REPAIRS FOR 1985: 13.0%

3.2.2 Calculation of Total Rent Increase

The final rent increase allowed by the Régie is the summation of all rises due to operating expenses, net income adjustment and adjustment for major improvements and repairs. The approximate rate of rent increase is then calculated by dividing total increases by the gross operating income from the building; it is that average rate which shall be applied to each dwelling being the subject of a claim and located in that building. However, special provisions may be taken into account in the calculation of the rent increase pertaining to a particular dwelling, especially if an expense does not apply to it. Thus, water and utility taxes are considered separately according to the information appearing in the «Dwelling

Schedule»; similarly, rent adjustment for major improvements and repairs can only be passed on to a tenant if the latter derives direct benefit from these investments.

Finally, let us recall that rent control does not apply to buildings which are less than five years old. Such an exemption aims at encouraging new rental construction so as to avoid undersupply in the medium and long-term as well as aging of the rental dwelling stock. Whether this goal is achieved will be discussed later on.

Table 5 illustrates the rent rise calculation method resorted to by the Régie, as it appears in the 1985 Calculation Form.

TABLE 5

Summary of Rent Increase Calculation Method - 1985 Form

• Annual Rent of Dwellings Leased in March 1985				A_1	
• Estimated Annual Rent of Vacant Dwellings in March 1985				A_2	
• Estimated Annual Rent of Dwellings Occupied by the Landlord, his Family, the Janitor or other Employees in March 1985				A_3	
• Annual Income from Additional Services (April 1, 1984 to March 31, 1985)				A_4	
TOTAL POTENTIAL GROSS INCOME				$A_1 + A_2 + A_3 + A_4$	= $\underline{A}$
TAXES AND INSURANCE:	Cost of Year Preceeding March 31, 1985	MINUS	Cost of Previous Year		
• Municipal Taxes	B_1^t	-	B^{t-1}	B_1	
• School Taxes	B_2^t	-	B_2^{t-1}	B_2	
• Insurance	B_3^t	-	B_3^{t-1}	B_3	
OTHER EXPENSES:	Cost from April 1, 1984 to March 31, 1985	X	Expected Increase Rates		
• Oil	B_4^t	X	4%	B_4	
• Gas	B_5^t	X	0%	B_5	
• Electricity	B_6^t	X	0%	B_6	
• Maintenance Expenses	B_7^t	X	3%	B_7	
• Management Costs (5% of A)	B_8^t	X	4%	B_8	
TOTAL OPERATING EXPENSES	$= B_1^t$ to $B_8^t = B^t$				
TOTAL INCREASES RELATED TO OPERATING EXPENSES				= B_1 to B_8	= $\underline{B}$

ADJUSTMENT OF NET INCOME • Total Gross Potential Income: A MINUS • Total Operating Expenses: B^t • Net Income = C^t X 2%	=	Increase Related to Adjust. of Net Income	= C
ADJUSTMENT FOR MAJOR IMPROVEMENTS AND REPAIRS • Major Improvements and Repairs made between April 1st, 1984 and March 31st, 1985 = D^t X 13%	=	Increase Related to Adjust. for Maj. Improv. and Repairs	= D
TOTAL INCREASES ALLOWED	=	A+B+C+D	= E
APPROXIMATE RATE OF INCREASE	=	E/A	= E%

3.2.3 Quebec Versus Ontario: Comparing Methods

Although our mandate does not include any reference to a comparative analysis between various rent control systems, we believe it is important, considering the context in which the current report takes place, to bring out, although superficially, the main differences - and similarities - between the Ontarian system and that prevailing in Quebec. We shall emphasize only aspects pertaining to the determination of rent increases, and avoid procedural issues.

a) Rent Regulation in Ontario: The Broad Parameters

Rent regulation in Ontario is defined as a system of «limited rent increases», whereby rent rises are based on cost increases incurred by a landlord for his residential complex taken as a whole (cost-pass-through method). In that respect, it is quite similar to the system prevailing in Quebec, where increases in operating costs are also the major component of rent rises and where rent increases for individual dwellings are, by and large, determined by a proportional apportionment of total increases allowed for the whole building. There are, however, major differences between the two systems:

i) Firstly, the Ontarian rent regulation system is a twofold system providing landlords with either of the following possibilities:

. The landlord may increase the rent on a particular dwelling by a statutory 6 percent amount - now to be lowered to 4 percent - without having to apply to the Residential Tenancy Commission. He must however send the tenant a «Notice of Rent Increase» not later than 90 days before the new rent becomes effective. This process is referred to as «Rent Control».

. If the landlord wishes to increase rent by more than 6 percent, he must then apply to the Commission for a «whole building review» whereby he must present evidence and make submissions to support a request for a total rent increase for all the units in the complex. In such a case, the increase pertaining to the whole building is apportioned equally amongst the rental units, unless otherwise stated by the Commission. This process is referred to as «Rent Review».

Thus, unlike what is found in Quebec, the Ontarian rent regulation system allows for an automatic and universal adjustment of rents which - in its initial design at least - explicitely internalizes inflation, be it only partially.

ii) Secondly, whereas the system prevailing in Quebec considers mostly PAST COSTS as the basis for rent increase calculation, in Ontario, cost increases are ESTIMATES referring to the «Projected Year», that is the year following the landlord's application to the Commission (Year 2) and pertaining to which rent increases are claimed.

iii) Thirdly, while both systems offer either party to a claim the possibility to appeal before the rent control authority, only the Ontarian system provides for an appeal to be made before the Divisional Court for a question of law related to an increase in rent.

iv) Fourthly, the two systems also differ on the exemption issue: whereas, in Quebec, buildings that are less than five years old do not fall under the jurisdiction of the Régie, in Ontario, residential complexes built after 1975 or converted to rental uses after that date, as well as rental units with monthly rents of 750$ or more are exempted from controls. In the latter case, the exemption rests with the assumption that tenants living in such premises can afford paying market rents and, therefore, do not need any form of protection. The exemption philosophies underlying each system thus diverge quite radically: while both aim at promoting new rental supply by relieving investors in new rental projects from controls, this measure, as applied in Québec, is only temporary (5 first years). Besides, the 750$ exemption prevailing in Ontario is clearly demand oriented and designed so as not to subsidize unduly a very specific and reduced portion of rental demand pertaining to luxury tenancies. It is worth

noting though that the current Ontario government has promised to remove both the 750$ and the past-75 exemptions.

v) Fifthly and finally, there are marked discrepancies between Ontario and Quebec rent regulation systems with respect to legal provisions pertaining to tenants' protection form «excessive» rent rises. Indeed, whereas, in Quebec, a tenant is assumed to have accepted the proposed rent increase unless he notifies the landlord of his refusal within one month of the latter's notice, in Ontario, the tenant can be paid back a rent rise illegally set up by his landlord, whatever the period that has elapsed since the increase came into effect.

b) Rent Increases: The Variables

Rent increases allowed under the Residential Tenancies Act are based, as said earlier, on cost increases. However, what the Ontario Act defines as costs includes elements which are termed otherwise under the «Régie du logement» Act and, consequently, receive a different treatment.

i) Operating Costs include real estate taxes, insurance expenses, heating costs, service costs, maintenance and ongoing repairs, management and supervision costs (which should not represent more than 5 percent of total revenues), as well as consultant fees in connection with the case presented before the Commission. Besides, they also include uncollectable rents (bad debts) which are not taken into consideration in the Quebec system.

ii) Capital Expenditures are treated as a debt payable over the estimated useful life of the asset concerned, the amortization amount being the annual cost of retiring the debt by blended payments of principal and interest. Thus, the Ontario system provides investors with the possibility of passing capital expenditures - such as a new roof - through rent increases each time, and only in as much as, they are repeated. Such an approach contrasts with the system prevailing

in Quebec whereby major improvements and repairs are regarded as an investment on the same grounds as initial equity is, and are therefore expected to yield a fair and permanent return to landlords incurring them, notwithstanding the fact that improvements have a finite life. Although the question could be raised whether principal repayments should be allowed as a «cost» rather than being treated as an «asset», both interpretations can ultimately be justified.

iii) Financing Costs probably represent the most delicate issue to deal with in the Ontario rent regulation system: since repayments of principal and interest on money borrowed to either purchase a building or refinance a loan may be passed through to tenants[8], any rise in interest rate as well as any new transaction on a building are most likely to be translated into a rent increase. Clearly, the pertinence of including principal repayments in the cost increases to be passed through remains doubtful; besides, the fact that rent rises pertaining to increases in financing costs are determined on a case-by-case basis rather than on the grounds of the average increase in the cost of borrowed capital (as it is in Quebec) may eventually result in the proliferation of fictitious transactions, whereby building prices are artificially boosted.[8a]

iv) Financial Loss (in Year 2) resulting from other than normal operating circumstances may justify a rent increase sufficient to bring the landlord to the «break-even» point. However, if such a loss is due to an increase in financial costs resulting from his purchase of the residential complex, the portion of rent increase attributable

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[8] Provided the loan that gave rise to such cost rises represents no more than 85 percent of the purchase price of a building, or 95 percent in the case of a certain new project, and that this loan is in the form of a notional mortgage with blended payments on a reasonable amortization period.

[8a] It should be added, though, that under the current Ontarian system, rent increases stemming from higher financing costs are limited to 5 percent, spread over five years.

to the rise in financing costs shall not represent more than 5 percent of the previous rent. There is no equivalent provision in the rent regulation system prevailing in Quebec.

v) Relief of Hardship is yet another characteristic of the Ontario Act. Under this provision, the landlord may be allowed by the Commission to increase rents so as for gross revenue to exceed total costs by up to 2 percent. Although this element has no direct equivalent in Quebec, it may bear some resemblance with Net Income Adjustment for building value appreciation, which also raises rents in order to improve both return and value.

By and large then, and despite some similarities, the two systems differ quite markedly on several points, namely with respect to vacancies and bad debts, in the way capital expenditures and financing costs are accounted for, and by the fact that in Ontario, financial losses may be offset through rent increases. The case-by-case approach used in the Ontario system also strongly contrasts with the average-cost-increase approach used in Quebec. Table 6 summarizes those differences.

TABLE 6

Major Differences between Ontario and Quebec Rent Regulation Systems

ONTARIO	QUEBEC
• Cost-pass-through method.	• Idem.
• Statutory inflation-related 6% rent increase.	• No statutory increase.
• Rent review based on individual, estimated cost increases for "Projected Year".	• Rent increases mostly based upon past, average cost rises.
• Operating costs include vacancies and bad debts incurred by the landlord.	• No account is taken of either variable in the calculation of gross income which is thus indicative of potential rather than effective rental income.
• Capital expenditures are treated as a debt to be amortized over the useful life of the asset, with both interest and principal payments being deducted as a current cost and indirectly translated into rent increase.	• Major improvements and repairs are seen as an investment: the landlord is rewarded by being granted a fair rate of return on the amount invested.
• Increases in financing costs (principal and interest) incurred by the landlord upon purchase or refinancing of the building are directly passed through to tenants.	• Fluctuations (either positive or negative) in the average cost of capital over last five years are used to adjust net income accordingly.
• Financial losses may be translated into rent increases until break-even-point is reached.	• Takes no account of financial losses.
• Relief-of-hardship provision allows for an upward adjustment of rents up to the point where gross revenue exceeds total costs by up to 2 percent.	• Net income is eventually adjusted by a non-negative, discretionary percentage to reflect the average increase in real estate values.
• System allows for an appeal to be made before the Divisional Court for a question of law.	• The ultimate decision with respect to rent increase determination rests with the Régie.
• The tenant can be paid back an "illegal" rent rise, irrespective of the period of time that has elapsed since the new rent became effective.	• The tenant must notify the landlord of his refusal within 1 month of the rent rise notice; otherwise, he is assumed to have accepted.
• Exemptions to the Act: - Residential buildings built or converted into rental uses after 1975; - Units with monthly rents of $750. or more.	- New residential buildings less than 5 years old.

3.3 Advantages and Weaknesses of the Current Rent Control System in Quebec

In the current section, we shall attempt to briefly discuss the main advantages and weaknesses of the rent control system prevailing in Quebec, on the grounds of our previous analysis.

3.3.1 Main Advantages

a) A first advantage of the rent control system prevailing in Quebec lies with the fact it adopts a discretionary approach whereby the negociation between landlords and tenants is emphasized. Rent increases are thus left to the landlord's initiative, with whom rests the responsibility of deciding whether a rent rise is needed considering the cost increases he must face.

b) Besides, as a corollary of the former point, the absence of any official statutory rent increase rate prevents rent rises from being universally applied to every dwelling and from directly internalizing inflationary trends, in as much as such a statutory increase is related to inflation. Having said that, the «average» rent increase announced annually by the Régie may be viewed as an unofficial landmark for landlords, thereby serving a role very similar to the statutory increase existing under the Ontarian system. However, the fact remains that any rise even if lower than the «prescribed» level, can be rejected by a tenant and eventually lead to a claim before the Régie. Whether such a feature is truly an advantage of the system depends upon which point of view one adopts.

c) Another advantage of this system is that it is «market-sensitive» in that it takes into account most costs as well as macro-economic variables - such as the marginal cost of capital and the opportunity cost of capital - which regulate a market economy and form the very basis upon which return requirements are determined.

d) At the same time, the fact that it resorts to average cost increases rather than to individual situations - as in the case of the Ontario

system - greatly reduces the risk of encouraging sub-optimal uses of funds and highly speculative real estate activities, as well as bad management.

e) Similarly, the spread over time of fluctuations in the cost of financing via the recourse to a weighted moving average technique tends to avoid abrupt rent increases that could be detrimental to tenants, while allowing nevertheless for the most recent changes in interest rates to be given more importance. Moreover, the possibility of integrating negative fluctuations into the calculation of the net income adjustment factor implies that rent increases pertaining to the rise in financing costs are not frozen forever into the new rent. It is true, however, that small landlords might be the first to suffer from the moving average method in that they are more exposed than large investors to cash-flow problems when refinancing takes place at a higher interest rate. A possible way of dealing with that issue may be to change the weighting factors so as to increase the relative importance of the last year[9].

f) Another interesting aspect of the Quebec legislation on rent control is that it induces lanlords to maintain and improve the quality of the existing rental stock by granting them with a reward on the funds they invest in their buildings for major repairs and improvements, and which is intended to match the average opportunity cost of capital available to investors. We believe such an approach to be an efficient means for diverting funds from other sectors into residential tenancies, in as much as the market allows for such investments to be translated into higher rents and higher real estate values, and as long as the reward granted proves sufficient to compensate lanlords for the actual cost of borrowing money. This might not always be the case, since funds lent

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[9] For instance, instead of having .33, .27, .20, .13, .07 as weighting factors, these could be set as follows: .40, .25, .20, .10, .5, or even .50, .30, .10, .5, .5.

for majors repairs and inprovements will often command interest rates that reflect second, or even third, mortgages.

We deliberately omit to mention as an advantage of the system the exemption for newly built units: although it might be considered as an incentive for the renewal of rental housing stock, its temporary character as well as the overriding prominence of existing rental units over new ones seriously waters down its intended purpose. In that respect, the system prevailing in Ontario appears more efficient, although the marginal influence of newly built units in the overall determination of market rent levels remains problematic, at least in the short-term. More will be said on that issue later on. .

3.3.2 Main Weaknesses

a) As we have seen earlier, the rent regulation operating in Quebec assumes the rent base from which increases are determined is already a fair market rent, and that rent rises will only help maintaining the competitive character of the investment. When, for any reason, this is not so, the system will tend to perpetuate the discrepancy between market rent and the effective rent charged to the tenant: indeed, in theory at least, a new tenant entering the premises will have his rent determined on the basis of the previous one, which must be written down on the lease[10]. We believe a relatively simple way to deal with that issue would be to allow the below-market rent to be adjusted to market levels upon a change in the occupant of the dwelling; without being in anyway detrimental to the current tenant, such a device would let the market play its role and eventually lead to a full, although progressive, adjustment of rent levels to market standards.

b) The absence of any explicit statutory rent increase rate has been described as a positive feature of the Quebec system in that it pre-

[10] In practice, however, the landlord may circumvert this rule by keeping dwelling unoccupied for one or two months, so as to avoid any contact between the previous tenant and the new one.

vents rent rises form being universally applied to all units of the residential rental market. However, the fact that any increase in rent may be opposed by tenants leads to unduly overcharging the Régie with claims and may involve heavy costs to small landlords for whom real estate investment is but a complement to their main occupation and the preparation of a claim before the Régie, a relatively heavy burden. Since the goal of rent control is to prevent «excessive» rent increases, we believe it would be wise for the Régie to adopt some sort of informal and unofficial landmark - say, an average rent increase rate as the one calculated every year by the Régie - that could be used as a criterion for filtering claims. Such an operation could take place at STEP 3 (Table 1), that is upon submission by the landlord of an application before the Régie.

c) A third element we believe to be problematic concerns the use of potential, rather than effective, gross income as the basis for calculating rent increases. This raises the question whether vacancies and bad debts should be taken into account. When it was initially decided not to do so, the reason was that landlords were assumed to have considered these two items as part of their normal business risk and established basic rents accordingly, the underlying assumption being that vacancy rates were stable over time. Such an assumption, though, denies regional differences which may arise from different market situations and that may lead to severe cash-flow problems without landlords being in any way responsible for these problems. A recent example may be brought forward which illustrates that the government, through some of its policies, may itself have caused vacancy rates to surge to record levels in specific segments of the Quebec Metropolitan residential rental market[11].

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[11] Indeed, by encouraging new house construction and home ownership, the «Corvée Habitation» program induced would-be home owners to hasten their decision to purchase a house, thereby depriving the local rental market from a significant share of its traditional clientele.

On the other hand, if losses due to vacancies and uncollectable rents were fully passed through to tenants, this would be an open encouragement to mismanagement by investors and should therefore be avoided. We think that, while bad debts should not be deducted from gross potential income, there would be place for at least part of losses from vacancies to be accounted for in the calculation of rent increases. For instance, the Régie could consider as deductible costs all vacancies over and above a predetermined vacancy rate considered as «reasonable», that is, indicative of a relative equilibrium between supply and demand, up to a certain ceiling which may be defined as the mean vacancy rate pertaining to a given year and a particular metropolitan region, plus one standard deviation; unit type may eventually be integrated in the calculation as well[12]. Besides, rent increases pertaining to vacancies could be prevented from being permanently built into the rent base by resorting to a device similar to that used in the calculation of the net income adjustment factor and whereby any negative difference between the allowed ceiling and the «normal» vacancy rate would be stored in a reserve and used to reduce the vacancy allowance of the following years. CMHC statistics on vacant rental units, produced twice a year - in April and October - and on a regional basis, could be used for that purpose, although a special treatment would be made necessary to account for the relative weight of each unit type in the overall rate.

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[12] For instance, if 2.5 percent is adopted as the «reasonable» vacancy rate, and considering the 1984 mean vacancy in the Quebec Metropolitan Region for two bedrooms units stood at 3.2 percent (unweighted) with a standard deviation of 1.8 percent, then the maximum amount deductible as «vacancy costs» from the 1985 gross potential income (provided all units in the building are two bedrooms units) would be measured as follows: GROSS POTENTIAL INCOME X (3.2% + 1.8%) - 2.5% = GPI x 2.5%. Integrating the «reserve» concept into the calculation would lead to the following equation: $v_t, r_t = (\mu+\sigma)_{t-1} - n + r_{t-1}$,

where:

v_t = vacancy allowance at time «t», with v_t 0;
r_t = reserve at time «t», with r_t ' 0;
$(\mu+\sigma)_{t-1}$ = allowed ceiling at time «t»;
n = «normal» vacancy rate;
r_{t-1} = (negative) reserve at time «t-1».

d) The «less-than-five-years-old» exemption for residential rental buildings may be seriously questionned as to its actual efficiency in promoting new construction, and for two reasons. Firstly, its duration is relatively short-lived and does not guarantee the landlord/investor that his financial situation in five years from now will allow for a reasonable return to be earned on its initial investment. In that sense, the Ontarian exemption whereby buildings built after 1975 are free of any rent control is certainly a better encouragement to rental stock renewal.

But the main argument for criticizing the exemption prevailing in Quebec remains that even though new buildings can have their rents established at market levels, most of the rental market depends upon existing dwellings subject to regulation, whose weight is overriding and which ultimately set the pace of both rent levels and, indirectly, rent increases new buildings' landlords may realistically ask for.

The problem raised here is a fundamental one and refers to the ability of the current system to allow for stock renewal. More precisely, it can be argued that even though the average level of rents prevailing on the market can provide owners of existing rental buildings with competitive returns, this might not be the case with new buildings whose construction costs can be expected to drive economic rents above what the market can bear from equivalent units. Such a situation will occur even in the absence of any rent control regulations, for instance whenever rental supply far exceeds demand; however, rent control will tend to enhance the problem, and possibly make it chronic. Indeed, whereas, in an uncontrolled market, new construction will automatically resume as over-supply turns into a situation of relative scarcity and rents rise until it becomes profitable to build new units, this equilibrium mechanism may be prevented from operating, or at least, greatly delayed, under rent control. As emphasized earlier on, the Quebec system is meant at controlling excessive rent rises only, not the overall level of rents. However, all existing units are potentially affected by the controls, with the resulting politi-

cal risk impacting more heavily upon the financially more fragile new supply segment of the residential rental market - except, maybe, for the luxury unit sub-market which remains relatively safe.

Finally, it should be stressed that the current issue is directly related to the «rent basis» problem that the prevalent legislation regards as an exogenous variable lying outside its direct control. In that respect, the system operating in Ontario seems more appropriate in that buildings built after 1975 will eventually form a sufficient portion of the overall rental market to impact upon rent levels, thereby countering the negative incentive our second argument suggests. To illustrate our point, let us recall that privately initiated rental apartment completions for all Canadian metropolitan areas in 1984 accounted for a mere 1.5 percent of the overall private rental apartment market (as of March 31 1984)[13].

As for the question whether other exemptions should be added to the Quebec rent control system, we believe something similar to the 750$ exemption prevailing in Ontario could eventually be applied, although with a mechanism allowing for a progressive decontrol to be made within some sort of «decontrol corridor» defined at one end by a lower monthly rent limit (say, 500$) below which rent control would be fully applied and, at the other end, by an upper limit (say, 750$) above which rents would be totally uncontrolled. Such limits could be periodically revised so as to account for inflation or some other price index. From our point-of-view, this type of exemption is perfectly justified since it applies to a relatively limited category of tenants who do not need any form of state backing, considering their general ability to pay the economic rent of their dwelling or to move into less expensive premises whenever this is not the case. We do admit, though, that while the above suggestion may prove

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[13] According to CMHC's Canadian Housing Statistics, 1984, 1977 privately initiated rental units were brought onto the market of major Canadian Metropolitan areas, while the corresponding stock stood at 1,295,413 units by March 31, 1984. If all rental units are included in the calculation, the percentage drops to less than 1.0 percent.

operational, its integration to the Quebec rent control system would make the latter more cumbersome as well as more costly.

e) Finally, we shall include in our discussion, be it superficially, considerations which, although relating to other than rent control issues, are nonetheless important in the overall assessment of the system. In particular, the process whereby unpaid rents may be recovered by landlords as well as the tenant eviction process - in case of accelerated deterioration of the premises or nuisance to other tenants - should be carefully looked upon in light of the need for a better balance between the rights of tenants and those of landlords. It is worth noting that some of these issues have recently been reconsidered by the Régie and administrative measures adopted so as to speed up the recapture of unpaid rents, thereby reducing the landlord's burden in the claim setting procedure.

To conclude, the rent regulation system prevailing in Quebec, apart from a few weaknesses which, for most of them, may be quite simply corrected, emerges as a relatively intelligent system and worthy of being maintained in a slightly modified form, in as much as a rent control system is needed. We shall come back on this last point in our general conclusion.

4. RENT CONTROL IN QUEBEC: FREQUENCY, DISTRIBUTION AND INCIDENCE

In the current chapter, we shall look at the actual use of the rent control system in Quebec as well as at the distribution of rent increases in recent years amongst regions and according to buildings' characteristics. Finally, we shall analyse the incidence of rent control on the basis of a recent survey by the Régie du logement.

4.1 Actual Frequency of Rent Control Claims

Tables 7 and 8 provide us with a comprehensive picture of the growth and regional distribution of claims forwarded to the Régie from 1981 to 1984. The «claims received» give a good indication of the demand for the services of the Régie while «claims processed» display to what extent the government body was able to supply such services.

Besides, the breakdown of «claims processed» shows the relative importance over time of cases which are settledj through a formal decision by the Régie (settlements) as opposed to those which give rise to a negociation between the landlord and his tenant, either privately or though conciliation before the Régie (withdrawals). The main findings from these two tables may be expressed as follows:

TABLE 7

Claim Management by the Régie du Logement - Global Picture -

	1981	1982		1983		1984	
	Nb	Nb	% Δ81-82	Nb	% Δ82-83	Nb	% Δ83-84
TOTAL CLAIMS							
- CLAIMS RECEIVED	87 396	93 920	7.5	87 347	-7.0	70 543	-19.2
	(100.0)	(100.0)		(100.0)		(100.0)	
- CLAIMS PROCESSED	61 927	99 433	60.6	94 177	-5.3	80 840	-14.2
	(100.0)	(100.0)		(100.0)		(100.0)	
RENT DETERMINATION CLAIMS							
- CLAIMS RECEIVED	26 404	41 528	57.3	31 764	-23.5	21 577	-32.1
(% of total)	(30.2)	(44.2)		(36.4)		(30.6)	
- CLAIMS PROCESSED	14 139	35 610	151.9	41 703	17.1	26 006	-37.6
(% of total)	(22.8)	(35.8)		(44.3)		(32.2)	
OTHER CLAIMS							
- CLAIMS RECEIVED	60 992	52 392	-14.1	55 583	6.1	48 966	-11.9
(% of total)	(69.8)	(55.8)		(63.6)		(69.4)	
- CLAIMS RECEIVED	47 788	63 823	33.6	52 474	-17.8	54 834	4.5
(% of total)	(77.2)	(64.2)		(55.7)		(67.8)	

Source: Régie du logement.

TABLE 8

Claim Management by the Régie du Logement - Regional Breakdown -

	1981	1982		1983		1984	
	Nb	Nb	% 81-82	Nb	% 82-83	Nb	% 83-84
ALL REGIONS							
- CLAIMS RECEIVED	87 396	93 920	7.5	87 347	-7.0	70 543	-19.2
	(100.0)	(100.0)		(100.0)		(100.0)	
- CLAIMS PROCESSED	61 927	99 433	60.6	94 177	-5.3	80 840	-14.2
	(100.0)	(100.0)		(100.0)		(100.0)	
• Withdrawals	22 781	29 513	29.6	22 591	-23.5	22 365	-1.0
(% of total)	(36.8)	(29.7)		(24.0)		(27.7)	
• Delistings	4 912	7 657	55.9	4 553	-40.5	5 245	15.2
(% of total)	(7.9)	(7.7)		(4.8)		(6.5)	
• Settlements	34 234	62 263	81.9	67 033	7.7	53 230	-20.6
(% of total)	(55.3)	(62.2)		(71.2)		(65.8)	
MONTREAL REGION							
- CLAIMS RECEIVED	53 823	61 244	13.8	60 143	-1.8	46 271	-23.1
(% of total)	(61.6)	(65.2)		(68.9)		(65.6)	
- CLAIMS PROCESSED	36 911	61 394	66.3	66 043	7.6	54 754	-17.1
(% of total)	(59.6)	(61.7)		(70.1)		(67.7)	
• Withdrawals	12 451	16 295	30.9	14 177	-13.0	15 370	8.4
(% of total)	(20.1)	(16.4)		(15.1)		(19.0)	
• Delistings	3 466	5 232	51.0	3 098	-40.8	3 811	23.0
(% of total)	(5.6)	(5.3)		(3.3)		(4.7)	
• Settlements	20 994	39 237	86.9	48 768	24.3	35 573	-27.1
(% of total)	(33.9)	(39.5)		(51.8)		(44.0)	
OTHER REGIONS							
- CLAIMS RECEIVED	33 573	32 676	-2.7	27 204	-16.9	24 272	-10.8
(% of total)	(38.4)	(34.8)		(31.1)		(34.4)	
- CLAIMS PROCESSED	25 016	38 039	52.1	28 134	-26.0	26 086	-7.3
(% of total)	(40.4)	(38.3)		(29.9)		(32.3)	
• Withdrawals	10 330	12 588	21.9	8 414	-33.2	6 995	-16.9
(% of total)	(16.7)	(12.7)		(8.9)		(8.7)	
• Delistings	1 446	2 425	67.7	1 455	-40.0	1 434	-1.4
(% of total)	(2.3)	(2.4)		(1.5)		(1.8)	
• Settlements	13 240	23 026	73.9	18 265	-20.7	17 657	-3.3
(% of total)	(21.4)	(23.2)		(19.4)		(21.8)	

Source: Régie du logement.

a) Total claims received by the Régie rose by 7.5 percent between 1981 and 1982, as they reached a peak of nearly 94 000, but dropped thereafter to just over 70 000 in 1984. Claims related to the determination of rent increases are responsible for this pattern: the latter rose by 57 percent between 1981 and 1982, as they accounted for 44 percent of all claims. Since then however, they have experienced a steady decline, with the number of claims pertaining to rent increases falling to about 21 500 by 1984, that is nearly half their 1982 level. As we shall see, 1982 was characterized by numerous requests for significant rent rises from landlords, following strong increases in energy costs as well as in interest rates.

b) As for claims actually processed by the Régie, their high growth in 1982 is out of proportion with the rise in claims received, thereby indicating a major improvement in the Régie's efficiency with regard to claim management.

c) The Montreal region alone accounts for between 60 percent and 70 percent of all claims (either received or processed).

d) Claim withdrawals following a private agreement between parties or conciliation before the Régie represent between 27 percent and 37 percent of all claims processed every year by the Régie. Their relative importance, though, seems greater in the rest of the Province where they reached 32.7 percent of all claims processed over the 1981-84 period, as opposed to 26.6 percent in the Montreal region.

e) By and large then, most claims are still settled via a decision by the Régie; indeed, 64.4 percent of all claims processed in Quebec during that same period ended up that way.

In order to provide for a global assessment of the likely impact of rent control on the rental market in Quebec, Table 9 has been set up which displays the relative importance of claims forwarded to the Régie as

compared to total housing and rental stocks in the Montreal and Quebec regions, as of 1981.[14].

As can be seen from the 1981 situation, only a relatively small fraction of total housing stock and of total rental stock as well is affected by rent control provisions, despite strong yearly fluctuations. Thus, while 9 percent of all rental units in the Montreal region gave rise to a claim of some sort in 1981, only 2.9 percent of the rental market was actually subject to rent control as such (rent-related claims); in the Quebec Metropolitan Area, the proportion of rental units affected by regulations was somewhat higher, with figures reaching respectively 12.4 percent and 4.6 percent of the market.

[14] 1981 is the most recent year for which reliable information on tenure is available.

TABLE 9

Rent Control and the Residential Market

- the Montreal and Quebec Regions, 1981 -

	MONTREAL METROPOLITAN AREA - 1981	QUEBEC METROPOLITAN AREA - 1981
(1) TOTAL HOUSING STOCK (Nb. of dwellings)	1 026 925	195 470
(2) TOTAL RENTAL STOCK (Nb. of units)	598 997	96 758
-As a % of (1)	58.3	49.5
(3) TOTAL CLAIMS RECEIVED BY THE REGIE	53 823	12 000
- As a % of (1)	5.2	6.1
- As a % of (2)	9.0	12.4
(4) TOTAL RENT RELATED CLAIMS RECEIVED	17 381	4 453
- As a % of (1)	1.7	2.3
- As a % of (2)	2.9	4.6
(5) CLAIMS SETTLED BY THE REGIE	20 994	-
- As a % of (1)	2.0	-
- As a % of (2)	3.5	-

Sources: Régie du Logement
CMHC, Canadian Housing Statistics, 1984, table 106.

Therefore, rent control provisions can be said to affect ultimately a quite limited portion of the rental market. It is precisely this very argument which is often brought about by promoters of the Quebec system as the best proof that the latter in no way disturbes market mechanisms. We believe however such a statement tends to oversimplify the debate in that it denies the roles of expectations as a prominent element of market behaviour. Indeed, while relatively few rental units will have their rent increases determined by the Régie each year, rent control nevertheless potentially applies to the whole rental market (or to over 95 percent of it), thereby enhancing political risk to investors; and there is a little doubt that the negative incentive it represents for the latter did play some role in the progressive disengagement of large Canadian developers and financial institutions from residential rental investment activities in recent years[15].

4.2 Distributional Characteristics of Rent Increases: 1979-1984

The current section investigates the distribution of rent increases according to selected variables, namely location (i.e. the region), building size, rent level, construction year of building and heating features. Both «required» and «allowed» rises are analyzed, and the ratio between the two calculated so as to provide an indication of the Régie's laxism in granting rent increases. Besides, the availability of data over a five-year period (1979-83) - or a six-year period in the case of regional breakdown - allows for a comparison of such ratios over time.

Information pertaining to distributional characteristics of rent increases are displayed in Tables 11-A to 11-E, each table referring to a specific variable. Before analyzing that information though, let us have a look at Table 10 which provides a comprehensive picture of the main features characterizing rent-related claims.

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[15] See DES ROSIERS, François, Financial Institutions and Property Investment: The Canadian Case. Unpublished Ph.D. thesis, London School of Economics, London, U.K., 1984.

4.2.1 Distributional Characteristics of Rent-Related Claims

The main features emerging from Table 10 may be summarized as follows:

a) The vast majority (well over 80 percent) of rent-related claims forwarded to the Régie comes from either the Montreal or the Quebec region, with the former having gained in relative weight over the years.

b) Larger buildings (21 units and over) account for a growing proportion of claims, at the expense of small buildings (3 units or less).

c) Low-rent dwellings experienced a drastic reduction in their relative importance as a claim source while middle-priced and upper-rent dwellings increased theirs substantially; this phenomenon merely reflects the overall upward trend in costs, prices and rents.

TABLE 10

Distribution of Rent Increase Claims for Selected Characteristics

1979-1983

CHARACTERISTIC / YEAR		1979 %	1980 %	1981 %	1982 %	1983 %
REGION	MONTREAL	65.1	65.2	69.8	70.3	69.9
	QUEBEC	16.4	18.2	14.9	14.9	13.3
BUILDING SIZE	3 UNITS OR LESS	21.5	20.6	17.8	14.1	15.7
	4 - 20 UNITS	39.6	41.5	38.0	35.6	38.3
	21 UNITS AND OVER	38.9	37.9	44.2	50.3	46.0
RENT LEVEL	$200 OR LESS	68.9	60.1	39.7	28.2	20.0
	$201 - 300	25.6	31.7	43.6	47.0	42.8
	$301 - 400	3.9	5.9	10.6	16.5	27.5
	$401 AND OVER	1.6	2.3	6.1	8.3	9.7
CONSTRUCTION YEAR	BEFORE 1954	41.6	40.1	33.9	29.3	27.5
	1955-1969	39.9	40.8	45.1	45.2	46.0
	AFTER 1969	18.5	19.1	21.0	25.5	26.5
HEATING	NON-HEATED	31.3	32.1	25.5	24.0	28.4
	HEATED	68.7	67.9	74.5	76.0	71.6
TOTAL		100.0	100.0	100.0	100.0	100.0

Source: Régie du logement. "Statistics on Rent Increases: 1979-1983", April 1984

d) A rising proportion of claimants are landlords of buildings built after 1954 and, in particular, of buildings built after 1969. Although this trend partly stems from stock renewal, the shift in the distribution of claims by year of construction quite obviously occurs at a faster rate than the shift in the distribution of the stock itself, which suggests that the profile of the tenant population involved is also changing.

e) Finally, rising energy costs drove owners of rental units for which heating is included in the rent to become a prominent claim source and to raise their «claim share» over the years in accordance with increases in oil, gas and electricity prices.

4.2.2 Distribution of Rent Increases

Turning to Tables 11.A to 11.E, several points are worth emphasizing:

a) Firstly, at the overall level, rent increases requested by landlords fluctuated between 15 percent (1984) and 26 percent (1982) over the period under investigation, whereas increases allowed by the Régie varied from 6 percent (1984) to 15 percent (1982). Thus, the ratio of allowed to requested rises stood somewhere between 0.4 (1979 and 1984) and 0.7 (1981), thereby indicating the Régie's attitude towards rent increases is not a static one, but may be modified in accordance to the economic context prevailing at the time of the claim. In 1981 and 1982 for instance - that is, in the deepest of the recent recession - 70 percent and 60 percent respectively of rises demanded were actually granted.

b) The distribution of rent increases by region shows a relative stability of allowed requested ratios over space for a given year, the differential between regions hardly exceeding 10 percent or 0.1. As for rent increases demanded by landlords, discrepancies over space tend to remain relatively modest: indeed, variations around overall mean are generally confined within the 12 to 14 percent range, despite a minimum of 8 percent (or so) in 1983 and a maximum of 16 percent (or so) in 1984.

TABLE 11-A

Average Rent Increase (%) by Region: 1979-1984

YEAR / REGION	1979			1980			1981			1982			1983			1984		
	REQUEST-ED	ALLOWED	2/1	REQUEST-ED	ALLOWED	2/1	REQUEST-ED	ALLOWED	2/1	REQUEST-ED	ALLOWED	2/1	REQUEST-ED	ALLOWED	2/1	REQUEST-ED	ALLOWED	2/1
	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3
HULL	16.2	6.2	0.4	16.9	7.7	0.5	21.2	13.7	0.6	22.7	11.1	0.5	16.7	6.0	0.4	17.6	6.1	0.3
JONQUIERE	19.7	7.6	0.4	17.4	9.1	0.5	20.7	14.2	0.7	30.4	15.5	0.5	17.4	9.0	0.5	18.8	8.3	0.4
LONGUEUIL	18.8	7.5	0.4	17.4	9.0	0.5	17.4	12.9	0.7	26.8	14.6	0.5	15.2	8.7	0.6	12.8	5.4	0.4
MONTREAL	17.1	7.1	0.4	16.1	7.7	0.5	17.0	12.0	0.7	25.5	14.7	0.6	18.3	8.5	0.5	15.3	6.2	0.4
QUEBEC	14.8	7.2	0.5	14.7	9.1	0.6	17.0	11.7	0.7	25.7	15.0	0.6	15.1	8.5	0.6	12.1	5.1	0.4
RIMOUSKI	14.1	6.6	0.5	13.0	6.8	0.5	16.7	10.8	0.6	24.6	14.9	0.6	16.2	8.6	0.5	17.7	4.5	0.3
TROIS RIVIERES	18.6	8.2	0.4	18.9	9.8	0.5	23.3	15.4	0.7	31.5	17.2	0.5	18.2	9.5	0.5	15.4	7.4	0.5
GENERAL AVERAGE	16.9	7.2	0.4	16.0	8.1	0.5	17.2	12.2	0.7	25.8	14.8	0.6	17.5	8.5	0.5	14.8	6.0	0.4

Source: Régie du logement, "Statistics on Rent Increases: 1979-1983", April 1984.

TABLE 11-B

Average Rent Increase (%) by Building Size: 1979-1983

YEAR / SIZE	1979			1980			1981			1982			1983		
	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1
	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3
1 UNIT	23.9	7.7	0.3	29.2	11.3	0.4	27.1	11.6	0.4	29.6	14.2	0.5	17.9	9.5	0.5
2-3 UNITS	21.8	7.8	0.4	18.8	9.3	0.5	20.5	13.1	0.6	27.9	16.0	0.6	19.2	10.3	0.5
4-20 UNITS	17.8	7.1	0.4	17.3	9.1	0.5	18.3	12.9	0.7	27.7	14.9	0.5	17.5	8.9	0.5
21-100 UNITS	13.8	6.6	0.5	13.3	6.2	0.5	15.3	11.4	0.7	25.3	14.4	0.6	17.6	7.7	0.4
OVER 100 UNITS	13.1	7.3	0.6	12.8	6.6	0.5	14.6	10.9	0.7	22.3	14.2	0.6	16.1	7.6	0.5
GENERAL AVERAGE	16.9	7.2	0.4	16.0	8.1	0.5	17.2	12.2	0.7	25.8	14.8	0.6	17.5	8.5	0.5

Source: Régie du Logement, "Statistics on Rent Increases: 1979-1983, April 1984

c) Rent increases by building size display a less regular pattern, with the level of percentage rises requested by landlords being seemingly inversely related to the size of buildings (except for 1983 when rises demanded were quite similar). Thus rent increases requested for smaller buildings (1 to 3 units) fluctuated between 18 and 30 percent a year - with rises above 25 percent being common for 1 unit buildings - as opposed to variations within the 13 to 25 percent range in the case of larger complexes (21 units and over). Although the reason for such a difference is not clear, we may assume that small buildings' tenants - who have often been occupying the premises for quite a longt time, currently benefit from a preferential, lower-than-market rent, thereby inducing their landlord to use yearly rent rises as a means of catching up with the market.

d) The above interpretation is being reinforced by the information displayed in Table 11-C, which brings out an unambiguous inverse relationship between the level of rent increases requested and the absolute level of rent charged to tenants. Noteworthy is the fact that, throughout the period considered, rises demanded for dwellings with a base rent of 100$ or less are grossly twice as important (in percentage terms) as the overall average, this ratio being even far exceeded in 1983 as increases requested for such units reached an average of 48 percent. This situation most probably has to do with the fact that low rent units are also part of the oldest segment of the rental stock in which major renovation works are most common; thus, high demands by landlords could merely reflect higher quality standards. Besides, it should be kept in mind that the percentage calculation method itself is biased in that the lower the rent base, the stronger the percentage rise resulting from a given nominal increase.

Having said that, the fact remains that the tenants occupying those low-rent dwellings are also the ones who most benefit from rent control, from the strict point-of-view of their ability to pay: indeed, the ratio of allowed to requested rises remained for most of the period well below the 0.5. mark. Since they are most probably society's poorest ele-

ments as well, rent control may thus be viewed as operating an income transfer from wealthier citizens (landlords being regarded as part of that wide-embracing category) to more deprived ones.[16]

e) The analysis of Table 11-D reveals that the older the building, the highest the rent increase requested by the landlord. Although part of that feature may find its explanation in that a large proportion of low-rent units are located in older buildings, another reason rests with the fact that the need for major repairs and improvements - which account for a significant share of the average rent increase - grows with building age.

f) Finally, Table 11-E leads to the conclusion that rent rises requested by landlords are higher when they apply to non-heated dwellings, which may seem paradoxical in the light of the growth in energy costs that

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[16] The redistributive impact of rent control may vary depending on whether it is expressed in percentage or nominal terms. Referring to the year 1982, for instance, where requested rises reached record levels, it can be shown that, whereas the ratio of allowed to requested rises was the lowest for low-rent units (less than $100), the nominal amount by which rents were held down is actually higher for higher-rent units. Thus, applying the upper limit for each rent category and multiplying that figure; by the percentage differential between requested and allowed rises yelds the following results (1982):

unit rent	$100 and below	101-200	201-300	301-400	401-500
subsidy granted to tenants in dollars	$32.60	27.60	31.50	34.80	41.00

Thus, it would seem that, in 1982, tenants occupying higher-rent units and assumed to be upper or upper-middle, income households actually drew greater benefits from rent control than low-rent unit tenants. But again, it could be argued that such a conclusion may not hold anymore if such subsidies are measured on a "per household income dollar" basis.

has occured over the last ten years. The reason is that, while energy costs are actually a major component of rent increases for heated units, that component, although insignificant in the case of non-heated dwellings, is nevertheless more than compensated for by both major repairs and net income adjustment; besides, the base rent being lower in non-heated dwelling, the percent rise requested is consequently higher.

TABLE 11-C

Average Rent Increase (%) by Rent Level

RENT \ YEAR	1979			1980			1981			1982			1983		
	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1
	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3
LESS THAN $100	30.4	8.3	0.3	30.1	10.0	0.3	35.6	16.1	0.5	48.3	15.7	0.3	48.2	16.8	0.3
$101-200	16.8	7.3	0.4	16.6	8.6	0.5	19.6	12.8	0.7	29.5	15.7	0.5	21.3	9.8	0.5
$201-300	12.4	6.8	0.5	12.5	7.4	0.6	14.9	11.8	0.8	25.1	14.6	0.6	17.5	8.3	0.5
$301-400	12.5	6.1	0.5	12.9	6.5	0.5	13.7	10,9	0.8	22.8	14.1	0.6	15.0	8.0	0.5
$401-500	10.3	5.8	0.6	11.9	5.8	0.5	13.1	10.5	0.8	22.0	13.8	0.6	14.3	7.8	0.5
OVER $500	11.1	6.5	0.6	10.9	5.1	0.5	13.9	10.0	0.7	19.2	13.4	0.7	14.6	7.9	0.5
GENERAL AVERAGE	16.9	7.2	0.4	16.0	8.1	0.5	17.2	12.2	0.7	25.8	14.8	0.6	17.5	8.5	0.5

Source: Régie du Logement, "Statistics on Rent Increases: 1979-1983", April, 1984.

TABLE 11-D

Average Rent Increase (%) by Building Age

CONSTR. YEAR / YEAR	1979			1980			1981			1982			1983		
	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1
	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3
BEFORE 1940	21.9	7.9	0.4	19.5	9.3	0.5	22.0	13.8	0.6	30.3	16.3	0.5	20.1	10.2	0.5
1940-1954	18.4	7.3	0.4	17.6	8.8	0.5	19.2	13.4	0.7	27.1	15.5	0.6	18.8	8.5	0.5
1955-1969	15.0	6.9	0.5	14.7	7.4	0.5	15.9	11.9	0.7	24.9	14.7	0.6	17.1	8.3	0.5
AFTER 1969	13.9	7.4	0.5	13.4	7.7	0.6	14.8	10.6	0.7	24.5	13.6	0.6	15.3	7.6	0.5
GENERAL AVERAGE	16.9	7.2	0.4	16.0	8.1	0.5	17.2	12.2	0.7	25.8	14.8	0.6	17.5	8.5	0.5

Source: Régie du Logement, "Statistics on Rent Increases: 1979-1983", April 1984

TABLE 11-E

Average Rent Increases (%) by Heating Features

HEAT \ YEAR	1979			1980			1981			1982			1983		
	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1	REQUESTED	ALLOWED	2/1
	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3
NON-HEATED	21.2	7.2	0.3	19.8	9.0	0.5	20.9	12.2	0.6	29.3	14.4	0.5	18.9	9.2	0.5
HEATED	14.9	7.2	0.5	14.2	7.7	0.5	15.8	12.1	0.8	24.6	14.9	0.6	16.9	8.3	0.5
GENERAL AVERAGE	16.9	7.2	0.4	16.0	8.1	0.5	17.2	12.2	0.7	25.8	14.8	0.6	17.5	8.5	0.5

Source: Régie du Logement, "Statistics on Rent Increases: 1979-83", April 1984

To conclude on the current issue, we could say that, although rent increases allowed by the Régie tend, by and large, to follow rises requested by landlords - in that higher demands will result in higher allowances - the rent control system is designed so as to reduce discrepancies between rent increases pertaining to various regions, and building characteristics, thereby maintaining to some extent the present rent base structure.

4.2.3 Components of Rent Increases

Let us now turn to the analysis of rent increase components. Table 12 diplays the break down of rent rises into their constituent elements; the table is divided in two, the first portion showing the relative importance of each item for dwellings where the item concerned is part of the rent increase calculation, whereas the second portion refers to all rental units pertaining to which a decision on rent was rendered by the Régie. The main findings from Table 12 may be summarized as follows:

a) If we look at the first item, TAXES, it can be seen that its relative importance highly fluctuates from one year to another. A break down by building size would show that taxes usually result in a rent increase far greater for dwellings located in small buildings than for those situated in medium or large structures. A similar comment applies to INSURANCE costs.

TABLE 12

Components of Rent Increases
1979-1984

	PERCENTAGE OF RENT INCREASE DUE TO COMPONENT											
	DWELLINGS WHERE COMPONENT IS PRESENT						AVERAGE FOR ALL DWELLINGS					
YEAR / ITEM	79	80	81	82	83	84 (1)	79	80	81	82	83	84 (1)
TAXES	1.3	-0.5	1.8	1.1	0.3	0.6	1.1	-0.4	1.6	1.0	0.3	0.6
INSURANCE	0.6	0.1	0.2	0.4	0.4	0.2	0.3	0.1	0.2	0.4	0.3	0.1
ENERGY	2.4	2.7	3.6	4.7	1.8	1.7	1.8	1.9	2.9	3.9	1.4	0.6
CURRENT EXPENSES	1.2	0.9	1.4	1.8	0.9	0.9	1.1	0.8	1.3	1.7	0.8	0.8
MANAGEMENT COSTS	—	—	0.5	0.7	0.4	0.4	—	—	0.5	0.7	0.4	0.4
NET INCOME ADJUST.	1.5	4.4	4.5	5.8	4.1	2.1	1.5	4.4	4.5	5.8	4.1	2.1
MAJOR REPAIRS	3.1	3.1	2.8	2.9	2.5	2.8	1.4	1.3	1.2	1.3	1.2	1.5
TOTAL AVERAGE INCREASE	—	—	—	—	—	—	7.2	8.1	12.2	14.8	8.5	6.0

Source: Régie du Logement, "Statistics on Rent Increases: 1979-83", April, 1984

(1) The table has been updated with 1984 figures.

b) ENERGY expenses form a major component of average rent increases, varying between 10 percent (1984) and 26 percent (1982) of the latter; these percentages rise to between 21 percent and 33 percent if only dwellings where that item is present are considered. Besides, energy costs are significantly more important for heated units and for dwellings located in old buildings, due to inadequate thermal isolation.

c) CURRENT EXPENSES account, by and large, for 10 percent to 15 percent of rent increases, although their relative weight is all the more important as the building grows in size. As for MANAGEMENT costs, they represent a steady proportion of rent rises, somewhere around 5 percent of these.

d) NET INCOME ADJUSTMENT is systematically the major component of rent increases: thus, except for 1979 when its relative weight was comparatively low, it accounted for between 35 percent and 54 percent of rises. Its absolute importance reached a peak in 1982, as increases in interest rates resulted in net income adjustment alone raising rents by 5.8 percent.

e) Finally, MAJOR REPAIRS are also a prominent element in the determination of rent rises, at least in the case of dwellings for which that component is present. Besides, the rent of units located in smaller as well as older buildings are particularly sensitive to that variable: for instance, in 1982, major repairs were responsible for an increase of 15.1 percent in the rent of single-unit buildings that were directly concerned by such investments, whereas the overall average rise due to major repairs amounted to a mere 1.3 percent.

To summarize, it appears that, on average, net income adjustment, energy costs and major repairs form the main determinants of rent increases, representing altogether between 70 percent and 94 percent of overall rises allowed over the 1979-84 period.

4.3. Incidence of Rent Control in Quebec

We shall, in the current section, investigate the incidence of rent control in Quebec, using for that purpose a telephone survey sponsored by the Régie du logement and performed on a sample of the population of both landlords and tenants who were involved in a claim before the Régie in 1982. We shall essentially confine ourself to individuals involved in a rent-related claim, since this is the issue at stake here. The main information selected from the survey and providing a portrait of the socio-demographic and socio-economic profile of both landlords and tenants appears in Table 13, which leads to the following findings:

TABLE 13

Socio-Demographic and Socio-Economic Profile of Landlords and Tenants Involved in a Rent-Related Claim, 1982

VARIABLE	LANDLORDS (n = 180) %	TENANTS (n=180) %
SEX		
- male	78	53
- female	22	47
AGE		
- 18-24	1	3
- 25-34	10	19
- 35-44	30	23
- 45-54	36	12
- 55-64	15	15
- 65 +	8	28
AVERAGE	47	50
CIVIL STATUS		
- married	80	47
- unmarried	9	27
- widowed, divorced, separated	11	26
EDUCATION		
- 7 yrs or less	11	13
- 8-12yrs	36	48
- 13-15yrs	18	12
- 16 yrs +	35	27
AVERAGE	12.8	11.8
CURRENT OCCUPATION		
- worker	83	60
- unemployed	—	3
- house keeper	9	7
- student	—	3
- retired	8	23
- soc. welfare	—	4

VARIABLE	LANDLORDS (n = 180) %	TENANTS (n=377) %
TYPE OF OCCUPATION	(n=147)	(n=238)
- professional	20	25
- large business manager	12	1
- technician	4	6
- small business manager	29	10
- office worker	16	40
- specialized worker	14	10
- unspecialized worker	5	8
- agricultural worker	—	—
HOUSEHOLD SIZE		
- 1 person	11	39
- 2-3 persons	43	45
- 4-5 persons	40	15
- 6 or more	6	1
AVERAGE	3.29	2.13
GROSS FAMILY INCOME $	(n=154)	(n=231)
- Below 5000	—	4
- 5000-9999	1	15
- 10000-19999	8	23
- 20000-29999	16	19
- 30000-39999	10	13
- 40000-49999	8	5
- 50000 and over	24	3
- no answer	33	18
AVERAGE	45000	23000

Source: Régie du Logement, July 1983

a) The vast majority of landlords are men, while the tenants population is almost evenly split between males and females.

b) While over 80 percent of landlords are between 35 and 64 years old, nearly half of the tenant population is either in the 25-34 category (19%) or over 64 years of age (28%). This merely confirms that young households and elderly people form a significant portion of the rental clientele.

c) While the landlord population is composed of married people in a proportion of 80 percent, more than half of tenants (53%) are either unmarried or widowed, separated or divorced.

d) As for educational characteristics, more than half of the landlord population has a school attendance exceeding twelve years, as opposed to only 39 percent for tenants.

e) Whereas the vast majority of landlords are employed on either a full-time or a part-time basis, nearly one tenant out of four is retired; besides, 10 percent of tenants are either unemployed, live on social welfare or belong to the student population.

f) As professionals form a significant share of both landlord and tenant populations, the former is characterized by a high proportion (41 percent) of business owners and managers, whereas office workers account for 40 percent of the latter.

g) With an average of 3.29 persons per household, landlords' households are significantly larger than tenants', the latter being composed in a proportion of 39 percent of single individuals.

h) Finally, the average gross family income of landlords, which stood at 45 000$ in 1982, is twice as high as that of tenants (23 000$); besides, nearly one fourth of the landlord population earns 50 000$ a year or above. However, that income discrepancy is somewhat reduced if it is measured on a per capita basis. Indeed, considering that the

average household size stands at 3.29 persons for landlords as opposed to 2.13 persons in the case of tenants, the per capita income reaches $13700 for the former against $10800 for the latter, which leaves landlords with an advantage of 27 percent over tenants.

Thus, assuming rent control actually exerts a downward pressure on rent levels relative to what would prevail under an unfettered market, the Régie's survey tends to corroborate our earlier statement about rent control operating, by and large, an income transfer from wealthier individuals to less economically favoured households. Of course, this may not necessarily be the case and it might happen that a tenant who is, say, a high-wage professional dwell in a rental unit owned by a pensioner for whom rental revenues form a significant share of his relatively modest annual income; in such a case, the transfer clearly operates in the reverse direction, that is from lower to upper income households.

5. RENT CONTROL: THE INVESTOR'S POINT OF VIEW

We shall devote the current chapter of our report to the assessment of the Quebec rent control system from an investor's point of view. More precisely, we shall attempt to summarize the main comments and criticisms expressed by landlords through the voice of the corporate body serving as their official representative, namely the Corporation des propriétaires immobiliers du Québec (CORPIQ).[17] Most of the information presented here is taken from a report prepared by the latter in November 1981 and presented to the President of the Régie du Logement as a reaction of rental building owners to Act 107 creating the Régie; personal interviews with the Corporation's managers about prominent issues also proved particularly helpful to our understanding of the problems faced by landlords.

Topics to be discussed have been grouped into five sections pertaining to the rent determination process as well as to other aspects of the current legislation.

5.1. Rent Increase Determination Method

While investors seem to consider that, by and large, the criteria used by the Régie to determine rent increases are quite acceptable, they nevertheless question some aspects of the method which they regard as highly detrimental to their business.

5.1.1 The Rent Base Issue

As emphasized earlier, the rent control legislation implicitely assumes that the rent prevailing at a given time for a given dwelling is similar to the rent a comparable unit with equivalent locational characteristics would command on the market. Consequently, rent increases can only apply to market, and hence, «fair» rents. This, however, will not always

[17] CORPIQ groups over 900 members in the Quebec Metropolitan Region, which own around 65 000 rental units.

be the case. In particular, the situation may arise where a tenant having occupied a dwelling for a long time actually benefits from a «preferential», below-market rent which, according to the current legislation, will be transferred to the following tenant without any (formal) possibility for the landlord to adjust the rent to market level. Thus, the rent control system tends to perpetuate discrepancies between effective and market rents.

The rent base issue could be solved quite simply by allowing landlords to adjust rents to market levels whenever a change in tenant takes place.

5.1.2 Effective Versus Potential Gross Income

A major criticism of the current system rests with the use of potential rather than effective gross income. According to CORPIQ, vacancies and bad debts should be fully taken into account in the calculation of rent rises. Although less straightforward, our own position on that matter also suggests that «unpredictable» vacancies be deducted from gross income, at least up to a certain limit defined by the regional average inoccupancy rate.

5.1.3 Operating Expenses

Although taxes and insurance expenses may be accounted for on a case-by-case basis, most other operating expenses refer not to the actual costs rises incurred by the landlord, but to average increases based on regional or national indices. Such a practice, CORPIQ argues, tends to penalize investors for fuel, gas or electricity over-consumption by tenants, that is in as much as the latter tend to raise their energy consumption from year to year as a result of neglect and wastage: tenants will often say, let the windows wide open in winter without bothering about the resulting costs to the landlord. While the above scenario may currently occur, we personally disagree with the full cost-pass-through principle, in that it does not induce landlords to prevent tenants from over-consuming energy related services. The solution to the wastage problem ultimately

rests with such services being paid for by tenants on the grounds of their individual consumption, which requires that energy costs be measured on a unit-by-unit basis; this remains the only efficient way of making tenants aware of the costs they incur and of reducing over-consumption.

5.1.4 Net Income Adjustment

According to CORPIQ, the net income adjustment process does not adequately reflect current fluctuations in interest rates, with the result that any violent surge in financial costs - such as the one experienced in the early eighties - may drive landlords faced with refinancing procedures into deep financial troubles due to insufficient cash-flow. Our detailed analysis of that fundamental issue showed interest rate fluctuations are explicitely accounted for in the calculation of the net income factor, with recent changes in the cost of capital being given greater weight; however, we also acknowledged that weighting factors could eventually be modified so as to put even more stress on the latter.

5.2. Other-than-Rent-Determination Issues

The method used to determine rent rises is not the only point questioned by landlords; legal provisions contained in Act 107 and providing tenants with privileges regarded by CORPIQ as being excessive are as well a matter of concern. These mainly refer to claim procedures, rent collection, rent deposit before the Régie, vandalism and eviction procedures.

5.2.1 Claim Procedures

Since October 1980, the whole responsibility of setting up and forwarding a claim before the Régie is incumbant on the landlord. Thus, upon the tenant's refusal to pay the rise required, the rent is automatically frozen at its current level until a decision is rendered, which can take up to a year. Apart from the costs this may imply for the landlord, the burden procedural aspects impose upon the latter may act as a serious disincentive for small investors who are neither acquainted with these is-

sues nor benefit from «scale economies» large landlords may realize in preparing such documents.

5.2.2 Rent Collection

Rent collection is made more difficult by the fact that a 21 days delay is granted to the tenant for meeting his obligations; if generalized, such a practice may result in severe losses to the investor or even drive him into insolvency. Besides, the interdiction to require payment guarantees from the tenant upon lease signing and to ask for post-dated cheques to be produced increase the probability of non-payment of the rent.

5.2.3 Rent Deposit before the Régie

Whenever the landlord falls short from meeting his obligations, for instance with respect to the provision of services described in the lease and included in the rent, the tenant may either ask for a rent reduction or require that his rent be deposited before the Régie until the claim is settled. This, CORPIQ argues, may lead to abuses in that reasons invoked by tenants are often ungrounded while the amount deposited is most of the time out of proportion with the seriousness of the fault. Besides, the delay required for claim settlement is too long, while no interest on the amount retained is paid back to the landlord, even though he might be found not guilty.

Such provisions are believed by investors to encourage tenants' irresponsability and should therefore be reviewed accordingly. Only reasonable claims should be considered by the Régie and dishonest tenants, says CORPIQ, should be forced to pay a fine equal to a given percentage (say 10 percent) of the unpaid rent. Finally, the amount retained by the Régie should be proportional to the gravity of the claim and interests on that amount should be duly paid to the landlord for the withholding period.

5.2.4 Vandalism

Vandalism is a quite frequent feature of rental activities and landlords confronted with that problem are almost invariably the losers: although a landlord may deposit a claim before the Régie against a tenant who has caused voluntarily or by neglect an accelerated deterioration of the premises, the legal process is lengthy and may end up before the Provincial Court. Besides, it will often happen that the faulty tenant is already out of reach when the claim is processed, thereby preventing the investor from getting any compensation for the damages done to the unit.

5.2.5 Eviction Procedures

Eviction procedures do exist in Act 107 and may be resorted to either if a landlord wishes to occupy for his own use a dwelling already rented, or under extreme circumstances involving the non-payment of the rent or the causing of serious nuisance to other tenants. However, due to the very philosophy of the Act which views housing as a fundamental right, the eviction of a tenant tends to be regarded as an ultimate recourse and it may take between six months to a year before the problem-tenant is actually forced out of the building[18]. In the meantime, he may have caused much harm to both the landlord and other tenants. For that reason, CORPIQ suggests that eviction procedures be corrected in such a way as to discourage would-be trouble-makers to act irresponsibly.

Although the above suggestions should be studied in greater depth before modifying the Act along these lines, we generally agree with the overall principle underlying CORPIQ's argumentation: to summarize, tenants should not be granted abusive privileges nor should they be prevented from meeting the duties conferrred upon them by the lease. A similar argument, of course, equally applies to landlords, which raises - once again - the

[18] It should be mentionned that recent procedural changes now allow for non-payment related claims to be settled within seven weeks of the application date by landlords.

issue of finding the right balance between the rights and responsibilities of both parties.

6. RENT CONTROL: THE TENANT'S POINT OF VIEW

Following our review of the major requests currently formulated by landlords with respect to regulations prevailing on the Quebec rental housing market, it is but normal that the point of view of tenants on the rent control system be also taken into account, thereby providing us with the other side of the picture. Due to the absence of any formal, written statement on the subject, the following lines reflect the opinion of both individual tenants and tenant associations as reported by a representative of one of the largest tenant associations in Montreal, namely that of Côte-des-Neiges. Comments have been classified in two categories, depending on whether they originate from individual tenants or from official tenant associations.

6.1 General comments from Tenants

The general aspects of rent control which tenants currently complain about may be put as follows:

a) The landlord is granted an automatic annual rent rise (whatever the inflation rate) and in spite of the fact no improvement whatsoever might have been made in the dwelling. Tenants tend to regard rent rises as a direct reflection of housing services' quality level. Therefore, rents should not be allowed to be raised unless such services improve; similarly, a deterioration in the quality of housing services should translate into lowered rents.

b) The rent rise allowed by the Régie is often much too high. This comment refers to the situation that prevailed in the early eighties, namely in 1981 and 1982 while average increases of 12.2 percent and 14.8 percent respectively were allowed. Quite clearly, tenants tend to consider rent rises should be based upon their own ability to pay rather than upon some investment rationale.

c) Significant discrepancies do exist between rents charged for identical units, which is unacceptable. Here, tenants unconsciously raise the

rent base issue: since the current system is essentially confined to dealing with rent increases, discrepancies between initial rent bases charged for similar units are ignored and perpetuated over time.

d) At the hearing, the landlord is usually given more time to develop his argument and defend his point than the tenant. Although, theoretically, landlords and tenants are granted an equal opportunity to express themselves, it seems likely to believe that unimformed - or eventually intimidated - tenants do not fully use such an opportunity, especially when these experience language problems (as in often the case with immigrants). Besides, the mere fact that the landlord is the one charged with the burden of the proof might be brought forward as an explanation for the latter's prominent role in the claim.

e) Tenants are not systematically provided with the exhibits pertaining to the claim. Again, this refers to an informational problem: while tenants could insist upon being given all the documents in the case, they are not always informed of their rights.

6.2 More Specific Comments from Tenant Associations

In addition to the above comments, tenant associations also formulate more structured criticisms of the current rent control system which are directed at its very mechanics:

a) A first and major complaint is that controls are not universal but sporadic, thereby affecting only a small portion of the rental stock and generating discrepancies between rent levels charged for similar units. Consequently, tenant associations favour a universal control approach similar to that prevailing in Ontario and whereby a statutory increase is imposed upon all dwellings.

b) A second criticism refers to the fact that the rent rise determination process does not account for expenses incurred by tenants for major repairs and improvements to their dwelling. Since the landlord directly benefits from such expenses which will eventually translate into higher

rents and a higher building value, tenants should be systematically reimbursed or have their rent - or their rent rise - reduced accordingly.

c) Thirdly, the current system does in no way consider the landlord's behaviour upon establishing rent increases. Indeed, the landlord who neglects to fulfil his duties and does not provide adequate services, should be penalized by having his requested rent rise lessened or simply denied.

d) Fourthly, tenant associations disagree with the relative importance given to the Net Income Adjustment factor in the determination of rent increases, which they regard as excessive. Indeed, as was shown earlier on (cf. Table 12), net income adjustment currently accounts for one third to one half of the total rent rise allowed by the Régie. Without any clear understanding of the rationale underlying the calculation of this factor, it is hardly surprising that tenant associations be suspicious about its relative weight.

e) Fifthly and finally, the rent control system is regarded as totally inefficient with respect to controlling rents charged to new tenants: although landlords are legally bound to indicate on a new lease the lowest rent paid for a unit over the last twelve month period, they may easily circumvent regulations by managing so as to avoid any encounter between previous and new tenants.

To summarize, tenants and their representatives tend to display attitudes with regard to rent control which - as expected - differ radically from those of landlords. While criticisms concern both technical and procedural aspects of the current system, the general feeling amongst tenants is that rent control is too loose, too permissive and too generous for landlords whose basic psychology remains essentially profit oriented, that is, consists for most of the time in raising rents as much as possible while minimizing maintenance costs. Besides, it is quite clear that, by and large, tenants do regard housing as a right rather than as a normal

good subject to market forces; for that reason, they believe rents should be based upon their own ability to pay rather than upon investment profitability and competitiveness criteria.

7. GENERAL CONCLUSION: RENT CONTROL AND THE MARKET

In the light of our detailed analysis of the Quebec rent control system, it is now time for a global assessment of its performance and efficiency in preventing excessive rent increases, and of its current and potential impact upon the residential rental market.

By and large, and in spite of a few weaknesses stressed earlier on, we consider this system as being relatively «intelligent» in that it takes into account most of economic variables which play an important role in the profitability of real estate investment. In that sense, we may say that the rent control system prevailing in Quebec is «investor sensitive», although it remains, through its procedural and legal aspects, somewhat biased in favour of tenants. There is still room, of course, for improvement: for instance, allowing for base rents to adjust to market levels upon a change in tenant, accounting for part of vacancies in the calculation of gross income, increasing the reward for major repairs and improvements and being more selective with regard to claims that should be processed by the Régie would undoubtedly enhance investors' interest for rental activities without, for that reason, penalizing tenants unduly. Besides, the system could be made more fluent and less burdensome to landlords if certain procedural and legal issues of Act 107 pertaining to rent collection, rent deposit, vandalism, eviction procedures, etc. were reviewed so as to emphasize tenants' responsibilities and duties.

As for the efficiency of the current system in preventing abusive rent rises, it seems from empirical evidence that the Régie has reached its goal and that rent control has mostly benefitted tenants occupying low-rent, relatively old units located in small buildings and belonging most probably to the lower-income category. Therefore, in as much as rent control actually holds rents down, the current system can be said to

operate an income transfer predominantly from upper to lower-income households.[19]

So far, we have been dealing with the rent control issue, assuming a rent control system is actually needed and that the problem is essentially confined to finding the best one, that is, the one that will provide tenants with an adequate protection against abusive rent rises while at the same time, allowing for landlords to earn a reasonable return on their investment. The question should now be raised whether any control system is needed at all to achieve such goals. In order to deal with that issue, the impact rent control is likely to exert on the residential rental market in Quebec must be looked upon.

Let us recall in the first place that a rent control system is justified only in as much as it actually limits potential returns investors may get from an unfettered market. Besides, unless such a market is highly imperfect, its usefulness may be seriously questioned: indeed, in the absence of any particular feature - such as monopolistic or oligopolistic structure - that could prevent the market from operating smoothly, the generation of abusive rent rises should remain very unlikely since competition will force rents down to competitive levels. Under these conditions, rent control, flexible though it might be, will distort market mechanisms, thereby acting as an impediment to their harmonious functioning. Having said that, it should be stressed that the rent control system prevailing in Quebec remains ambiguous as to its actual objectives. More precisely, the question should be raised whether it confines itself to limiting abusive rent rises or seeks to establish a general policy of income redistribution and, if the latter is true, why it should parallel the market by attempting to provide landlords with a competitive return on their investment. This brings us to consider whether housing should be considered as a «normal» good whose production should be unrestrainedly subject to market forces, or a «semi-public» good due to its necessary character.

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[19] Subject to the reservations expressed in sub-section 3.3.1. paragraph f).

The issue discussed here is a fundamental one and should be considered from a long-term perspective. Indeed, if rent control eventually results in non-renewal and accelerated deterioration of the rental housing stock, tenants who may, in the short-term, benefit from «artificially» lowered rents could be in the long-run severely affected by any shortage in the provision of rental accomodations[20]. As stated previously, the rent control system prevailing in Quebec appears relatively wise in its attempt to protect tenants while providing landlords with a reasonable reward on their investment. However, in its present state, it is inadequate for dealing with the rental stock renewal issue. Indeed, the absence of any mechanism providing for a gradual adjustment of rents to market level directly affects new construction: since the construction cost of a new building far exceeds the market value of corresponding existing buildings, the economic rent charged for new units would have to be significantly higher than the rent charged for equivalent existing dwellings in order to provide the investor with a fair return. This, however, is unlikely as the level of rents prevailing on the market is predominantly dictated by the existing rental stock which is in its vast majority subject to rent control. Although there is actually a specific clientele ready to pay higher rents in order to live in a brand-new dwelling, such a relative advantage fades away once the building is 3 to 5 years old and joins the rank of all other existing buildings against which it must compete.

Although it is not the purpose of this paper to discuss in greater depth the very relevance of the Quebec rent control system, it is important to stress that the choice for a given system should rest upon a tight analysis of the long-term benefits and costs it is likely to generate. We do not suggest, though, that controls be abolished for there are obviously specific segments of the rental market in which tenants are prone to being abused by unscrupulous landlords: these are the poor, the el-

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[20] Annex B clearly shows that a significant drop in rental stock renewal has occured in recent years in both the Montreal and the Quebec regions. Although the over supply of the late seventies can be brought forward as an explanation for such a trend, it is likely that rent control did act as a disincentive to investors.

derly, the sick, the newly arrived immigrants and all those who are not in a position to have their rights protected: similarly, lanlords equally deserve protection against irresponsible tenants. In that sense, it might be wise to modify the current system so as to emphasize informational and procedural aspects rather than rent controls as such. The search for a better balance between the rights and duties of both landlords and tenants should be complemented by demand-oriented measures - such as housing allowances or income supplements - which tend to minimize market disturbances while helping tenants to deal with the affordability problem.

ANNEX A

CALCULATION OF THE NET INCOME ADJUSTMENT FACTOR PERTAINING TO THE BUILDING VALUE COMPONENT

As indicated in page 28 of the current document, the net income adjustment factor related to building value appreciation is determined exogenously to the system and on a discretionary basis. In order to bring it out, a "residual" technique must be used. Thus, we have:

Net income adjustment factor pertaining to building value component = Total net income adjustment factor MINUS Net income adjustment factor pertaining to fluctuations in interest rates

Hence:

Year	Total net income adjustment factor	Net income adjustment related to interest rate fluctuations	Net income adjustment factor related to building value appre ciation
80-82	4.4	10	-5.6
81-82	4.5	12.5	-8.0
82-83	5.8	8.0	-2.2
83-84	4.1	2.0	2.1
84-85	2.1	-3.0	5.1

ANNEX - B -

HOUSING STOCK ESTIMATES:
MONTREAL AND QUEBEC, 1976-1984;
(IN UNITS)

YEAR	MONTREAL				QUEBEC			
	COMPLETIONS	STOCK TOTAL(1)	STOCK RENTAL(2)	RENTAL/ TOTAL	COMPLETIONS	STOCK TOTAL(1)	STOCK RENTAL(2)	RENTAL/ TOTAL
1976	--	924,635	571,424	61.8	--	164,600	88,555	53.8
1981	14,778	1,026,925	598,697	58.3	3,499	195,470	96,758	49.5
1982	11,259	1,036,831	570,947	55.1	2,797	198,290	99,323	50.1
1983	16,822	1,048,280	567,358	54.1	4,907	202,161	100,761	49.8
1984	20,078	1,062,909	564,446	53.1	4,462	205,569	101,274	49.3

NOTES: 1. 1976 AND 1981 STOCK ESTIMATES ARE FOR JUNE, 1982-1984 ARE FOR YEARS END. 1982-1984 ESTIMATES ARE DERIVED USING A 0.51% ANNUAL STOCK LOSS FACTOR. (THE 1961 TO 1971 ESTIMATED URBAN QUEBEC ANNUAL STOCK LOSS FACTOR, AS FOUND IN SKABURSKIS, 1979.)

2. APRIL 1976 AND 1981 ESTIMATES ARE FROM THE CENSUS. ALL OTHER ESTIMATES ARE DERIVED BY WEIGHTING CMHC, VACANCY UNIVERSE. 1982-84 ARE FOR OCTOBER.

SOURCE: 1976 AND 1981 STOCK ESTIMATES FROM STATISTICS CANADA, CENSUS. COMPLETION ESTIMATES FROM CMHC, CANADIAN HOUSING STATISTICS STOCK LOSS RATIO FROM SKABURSKIS, DEMOLITIONS, CONVERSIONS, ABANDONMENTS, 1979, WORKING PAPER 2.

Research Studies

The following is a list of papers commissioned by the Inquiry.

No.

1 Slack, Enid and Sherry Glied. Rent Registry Alternatives.

2 Reid, Frank. Collective Bargaining for Tenants.

3 Jaffary, Karl D. Problems in the Regulation of Rents for Roomers and Boarders.

4 MacDonald, Daniel V. Constitutional Reference Re: The Residential Tenancies Act.

5 Fallis, George. Possible Rationales for Rent Regulation.

6 Hulchanski, J. David. Market Imperfections and the Role of Rent Regulations in the Residential Rental Market.

7 Sharp, Campbell, Pannell Kerr Forster Campbell Sharp. Survey of Financial Performance of Landlords.

8 Marks, Denton. Housing Affordability and Rent Regulation.

9 Steele, Marion and John Miron. Rent Regulation, Housing Affordability Problems, and Market Imperfections.

10 Clayton Research Associates Limited. Rent Regulation and Rental Market Problems.

11 Makuch, Stanley M. and Arnold Weinrib. Security of Tenure.

12 Hartle, D.G. The Political Economy of Residential Rent Control in Ontario.

13 Slack, Enid and David P. Amborski. The Distributive Impact of Rent Regulation.

14 Knetsch, Jack L., Daniel Kahneman and Patricia McNeill. Residential Tenancies: Losses, Fairness and Regulations.

15 Stanbury, W.T. Normative Bases of Rent Regulation.

16 Stanbury, W.T. Normative Bases of Government Action.

17 Stanbury, W.T. and P. Thain. The Origins of Rent Regulation in Ontario.

18 Stanbury, W.T. and I.B. Vertinsky. Rent Regulation: Design Characteristics and Effects.

19 Chant, John. Overview of Alternative Rental Housing Policies.

20 Foot, David K. Housing Demands: A Demographic Perspective.

21 Quirin, G. David. Regulatory Systems and their Applicability to Rent Controls.

22 Mascall, M. and Associates. Report of the Ontario Rental Housing Market.

23 Environics Research Group Limited. Financing Residential Rental Accommodation: A Survey.

24 Ekos Research Associates Inc. A Study of Landlords and Rent Regulation.

25 des Rosiers, Francois. A Rent Control System in Quebec.

26 Slack, Enid. The Costs of Rent Review in Ontario.

27 Muller, Andrew. Workable Rent Regulation: A Synthesis.

The following is a list of papers prepared by the research staff of the Inquiry.

28 Adams, Eric B., Pearl Ing and John Pringle. A Review of the Literature Relevant to Rent Regulation.

29 Adams, Eric B., Pearl Ing, Janet Ortved and Mary Jane Park. Government Intervention in Housing Markets: An Overview.

30 Pringle, John. Ontario's Residential Tenancies: A Statistical Profile.